

OVERSIGHT OF THE SINGLE AUDIT ACT

HEARING

BEFORE THE
SUBCOMMITTEE ON GOVERNMENT EFFICIENCY,
FINANCIAL MANAGEMENT AND
INTERGOVERNMENTAL RELATIONS

OF THE
COMMITTEE ON
GOVERNMENT REFORM
HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

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OVERSIGHT OF THE SINGLE AUDIT ACT

WEDNESDAY, JUNE 26, 2002

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT EFFICIENCY, FINANCIAL
MANAGEMENT AND INTERGOVERNMENTAL RELATIONS,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2247, Rayburn House Office Building, Hon. Stephen Horn (chairman of the subcommittee) presiding.

Present: Representatives Horn, Miller, Schakowsky and Maloney.

Staff present: J. Russell George, staff director and chief counsel; Bonnie Heald, deputy staff director; Henry Wray, senior counsel; Rosa Harris, GAO detailee; Justin Paulhamus, clerk; Michael Sazonov, Sterling Bentley, Joe DiSilvio, and Yigal Kerszenbaum, interns; David McMillen, minority professional staff member; and Ellen Rayner, minority chief clerk.

Mr. HORN. A quorum being present, the Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations will come to order.

Each year the Federal Government awards billions of dollars in grants, loans, loan guarantees, property and interest subsidies to State and local governments and nonprofit organizations. Last year alone, the Federal Government issued approximately \$325 billion in awards and grants to these entities. Prior to passage of the Single Audit Act, the Federal Government required financial audits of each grant program to ensure that the grant was being appropriately spent. This often resulted in grant recipients undergoing multiple audits.

For example, if Johns Hopkins University received grants from several Federal agencies, each grant was audited separately, often by different audit organizations. Since passage of the Single Audit Act, the recipient in this example, Johns Hopkins, undergoes one audit of all its grants and awards.

The Single Audit Act is intended to promote sound financial management including effective internal controls over Federal awards. The act requires audits of grant recipients that annually expend \$300,000 or more in Federal awards.

Each year about 30,000 single audits are performed. These audits have identified thousands of financial management weaknesses. It is the Federal Government's responsibility to ensure that these weaknesses are corrected. It is critical that the Federal departments and agencies that award these grants ensure that these

billions of taxpayer dollars are properly spent.

Today we will examine how effectively the Federal Government is accomplishing this goal. I welcome each of you, our witnesses, and look forward to your testimony.

[The prepared statement of Hon. Stephen Horn follows:]

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Opening Statement

Chairman Stephen Horn, R-CA

Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations

June 26, 2002

A quorum being present, the Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations will come to order.

Each year, the federal government awards billions of dollars in grants, loans, loan guarantees, property and interest subsidies to state and local governments and nonprofit organizations. Last year alone, the federal government issued approximately \$325 billion in awards and grants to these entities.

Prior to passage of the Single Audit Act, the federal government required financial audits of each grant program to ensure that the grant was being appropriately spent. This often resulted in grant recipients undergoing multiple audits. For example, if Johns Hopkins University received grants from several federal agencies, each grant was audited separately, often by different audit organizations. Since passage of the Single Audit Act, the recipient, in this example Johns Hopkins, undergoes one audit of all of its grants and awards.

The Single Audit Act is intended to promote sound financial management, including effective internal controls over federal awards. The Act requires audits of grant recipients that annually expend \$300,000 dollars or more in federal awards.

Each year, about 30,000 single audits are performed. These audits have identified thousands of financial management weaknesses. It is the federal government's responsibility to ensure that those weaknesses are corrected. It is critical that the federal departments and agencies that award these grants ensure that these billions of taxpayer dollars are properly spent. Today, we will examine how effectively the federal government is accomplishing this goal.

I welcome each of our witnesses and look forward to your testimony.

Mr. HORN. And now if we—as you know, all of the subcommittees have an oath, and if you’d stand with your people that back you up as well, the clerk will take their names. We’ve got about five, six behind you. Raise your right hand.

[Witnesses sworn.]

Mr. HORN. The clerk will note all of these fine gentlemen and ladies accepted the oath. Please be seated.

We’re going to move very rapidly today, because I have to be in a mark-up at the Transportation and Infrastructure Committee at 11 a.m. I’ll begin, and then we’ll move ahead very rapidly, and I’m sure you’re pleased.

The first witness is Sally Thompson, Director, Financial Management and Assurance, U.S. General Accounting Office. Nice to have you here again.

STATEMENT OF SALLY E. THOMPSON, DIRECTOR, FINANCIAL MANAGEMENT AND ASSURANCE, U.S. GENERAL ACCOUNTING OFFICE

Ms. THOMPSON. Thank you, Mr. Chairman, and I’m pleased to be here to discuss our report, which was conducted at your request and is being released at this hearing, on the efforts that Education, HUD and Transportation are doing to assure that the Federal award recipients take timely and appropriate actions to correct all single audit findings, and then I would also like to highlight three issues that merit additional attention to ensure that the single audit efforts are achieving the full benefits envisioned by the act.

Single audits are a critical element in the government’s oversight and monitoring of what you mentioned was over \$300 billion in Federal awards. In regard to our report, even though Education, HUD and Transportation had procedures in place to establish responsibility for identifying and reviewing single audits, we found little evidence that the three agencies had actually evaluated and concluded on the adequacy of corrective actions reported, and then notified recipients of the agency’s positions on the audit findings and the corrected actions. In other words, there’s a statute in place, there’s OMB guidance in place, there’s agency policies and procedures, but there is not accountability. This is not a compliance issue. It’s an accountability issue.

Specifically we’ve reviewed 60 1999 reports from these agencies for their biggest programs and their biggest recipients, and we found 246 audit findings, of which only 30 percent had management decision memos. The OMB circular requires the agencies to issue decision memos within 6 months of the receipt of their single audit reports. Even if they were to issue those management decision memos within 6 months, it would still be 15 months after the end of the audited period.

Agencies’ reasons for not following-up with management decisions included that they weren’t significant, although the audit requirements very specifically said only significant findings are reported; and, that they look at subsequent year-end single audit reports to indicate whether the recipient had indeed corrected the findings. However, when we add to the 15 months another year, and this is not a timely manner of following-up on the audit findings to make sure that they’re corrected.

Program officials from the three agencies also told us that they followup on corrective actions through activities such as site visits, phone conversations and review, again, of the subsequent audits. However, we found very little documentation that demonstrated these activities.

In addition to that, there is no agencywide analysis and reporting of the single audit information that was performed. We believe single audits provide valuable information for agency managers to use in strengthening accountability and oversight, and performing agencywide analysis of problems that may be consistent across single audits.

We also feel single audits are another element in the risk management assessment process to reduce improper payments, which is a key element in the President's management agenda. However, when we talked to the agency officials at the three agencies, they revealed that most of the program managers were not communicating this information to the top agencies.

We are recommending that the secretary of each of these agencies implement policies and procedures that clearly define roles and responsibilities and ensure accountability of timely and appropriate actions are occurring on all audit findings. We also feel that this reporting should include information on the types of audit findings identified in the single audit reports and the status of those corrective actions. The agency head could be doing agencywide analysis on these findings.

Now I would like to talk briefly about three issues that are of concern to us: Whether all single audits are being conducted, whether the recipients perform the proper monitoring of subrecipients, and whether the single audits comply with auditing standards.

In the audit universe, we generally have an honor system. We depend on the recipients to arrange the single audits. We have no government-wide tracking system that accumulates, tracks and reports the total amount of all awards expended by an agency or a recipient. This key is essential for being able to manage across the Federal Government.

Subrecipient monitoring. Right now when the States receive audit awards, grant awards, they are responsible for reporting to the agency. However, they distribute that money to many of the local governments and nonprofits, and the States are the ones that are held accountable for following up on those subrecipients. Agencies never know what those findings are, nor do they know whether they've been corrected or not.

The very last issue is audit quality. We have a survey that we did on the last report we issued to you. We found that the IGs participated in about 109 reviews and found significant problems with the audits that were being done in the area of internal control, as well as compliance. We believe that this indicates how major the problem is with the quality of audit control.

This concludes my remarks, and I'd be glad to answer questions.

Mr. HORN. Thank you.

[NOTE.—The GAO report entitled, “Single Audit, Actions Needed to Ensure That Findings are Corrected,” may be found in subcommittee files.]

[The prepared statement of Ms. Thompson follows:]

GAO**United States General Accounting Office**

Testimony

Before the Subcommittee on Government Efficiency,
Financial Management and Intergovernmental Relations,
Committee on Government Reform, House of
Representatives

For Release on Delivery
Expected at 10 a.m. EDT
Wednesday,
June 26, 2002

SINGLE AUDIT**Single Audit Act
Effectiveness Issues**

Statement of Sally E. Thompson
Director, Financial Management and Assurance

**GAO-02-877T**

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to (1) discuss our report,¹ which is being released at this hearing, on the efforts of the Departments of Education, Housing and Urban Development (HUD), and Transportation to ensure that federal award recipients take timely and appropriate actions to correct all single audit findings, and (2) highlight three issues that merit additional attention to ensure that single audit efforts are achieving the full benefits envisioned in the act.

Our review of the efforts of Education, HUD, and Transportation to ensure that federal award recipients corrected single audit findings generally found a lack of the required documentation of management decisions on audit findings and the evaluation of and conclusions on the adequacy of recipient actions to correct single audit findings. In commenting on the report, Education and HUD agreed with the findings and are moving forward to implement the recommendations. Transportation's comments raised several issues concerning both the scope of our audit work and the appropriateness of our conclusions and recommendations. Despite the comments and the issues raised, we continue to believe that our conclusions are sound and that the recommendations for agency actions are needed to help ensure the overall effectiveness of agencies' implementation of the Single Audit Act and their consideration and use of single audit findings.

The Federal Audit Clearinghouse, the organization the Office of Management and Budget (OMB) designated to receive single audit reports from federal award recipients, received about 34,000 single audit reports during calendar year 2000. About 5,500 of these reports contained audit findings. Despite these impressive figures, several single audit-related issues merit additional attention. These issues involve questions about whether (1) all required single audits are performed, (2) federal award recipients are adequately monitoring subrecipient² use of federal awards and the correction of single audit findings, and (3) the audits are performed in accordance with government auditing standards.

¹U.S. General Accounting Office, *Single Audit: Actions Needed to Ensure That Findings Are Corrected*, GAO-02-705 (Washington, D.C.: June 26, 2002).

²A subrecipient is a nonfederal entity that expends federal awards received from another nonfederal entity (i.e., the federal award recipient) that received awards directly from a federal agency to carry out a federal program.

According to OMB, federal awards for fiscal year 2001 totaled about \$325 billion of the \$1.8 trillion federal budget. These awards include grants, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, food commodities, and direct appropriations and federal cost reimbursements. The Single Audit Act, passed in 1984 and amended in 1996, is intended to, among other things, promote sound financial management, including effective internal controls, with respect to federal awards administered by state and local governments and nonprofit organizations. Under the act, those governments or organizations that expend \$300,000 or more in federal awards during the fiscal year are required to (1) maintain internal control for federal programs, (2) comply with laws, regulations, and the provisions of contracts or grant agreements, (3) prepare appropriate financial statements, including the Schedule of Expenditures of Federal Awards, (4) ensure that the required single audits are properly performed and submitted when due, and (5) follow up and take corrective actions on audit findings.

Three Agencies' Practices to Ensure Correction of Single Audit Findings

As discussed in the report we are releasing today, our work to review agency actions to ensure that recipients take timely and appropriate corrective actions to fix audit findings contained in single audit reports identified a number of fundamental concerns. Education, HUD, and Transportation had procedures in place to establish responsibility for identifying and reviewing single audit findings and for communicating that information to appropriate officials for action. However, the audit files at these agencies generally did not contain documentary evidence that the agencies had prepared management decisions, as required by OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, to notify the recipients of the corrective actions the federal agencies deemed necessary to correct the audit findings. Also, the files generally did not contain evidence that agency personnel had evaluated and concluded on the adequacy of the recipients' actions to correct the findings contained in single audit reports.

OMB Circular A-133 requires each federal agency to issue a written management decision on audit findings within 6 months of the receipt of the recipient's single audit report. (It is important to note that as many as 15 months could pass after the recipient's year-end date before the Single Audit Act, as amended, requires a management decision. This occurs because the legislation gives recipients up to 9 months after the period audited to file their single audit reports, and agencies have an additional 6 months to issue the management decisions.) These decisions document

management's conclusions on and notification to recipients on the adequacy of their planned, in progress, or completed actions to correct audit findings. In order to gauge agencies' practices in this area, we selected the 10 grantees awarded the most money for the two largest programs at each of the three agencies. Our analysis of actions related to the 20 single audits from each agency showed that collectively they had issued management decisions for only 75 (31 percent) of the 246 audit findings contained in the single audit reports included in our review.

The agencies noted several reasons for not preparing written management decisions including that (1) they considered the audit findings to be insignificant or not serious, (2) the single audit report stated that the recipient had corrected the finding prior to the report's issuance, and (3) the subsequent year's single audit report indicated that the recipient had corrected the finding. In our view, none of the reasons cited justify the nonissuance of a management decision. For example, by including a finding in a single audit report, auditors are indicating that the finding is significant since government auditing standards require auditors to report all significant findings in the report. The standards identify other means of communicating insignificant findings. Regarding the use of subsequent-year single audit reports to justify the nonissuance of a management decision, it should be noted that single audit reports must be issued no later than 9 months after the recipient's year-end. By waiting for the subsequent year's audit report, as many as 21 months could have expired from the end of the audit period for which the finding was initially reported to the receipt of the subsequent year's audit report. In our opinion, waiting for the subsequent audit report would not result in a timely notification to the recipient of the agency's position on an audit finding and the recipient's planned, in progress, or completed corrective actions.

OMB Circular A-133 does not distinguish between the types of findings or their seriousness when requiring written management decisions. In fact, ensuring that reported problems have been resolved is a central requirement under OMB Circular A-133. The circular requires agencies to ensure that federal award recipients take appropriate and timely corrective action on audit findings. Program officials at Education, HUD, and Transportation told us that they follow up on the implementation of corrective actions through such activities as site visits, phone conversations, and review of the subsequent year's single audit reports. However, we found very little documentation that demonstrated agency follow-up actions to ensure that recipients took the necessary corrective actions on single audit findings or the results of the follow-up activities.

cited above. While the audit files contained copies of recipient documents and other records, the files did not contain agency evaluations of or conclusions on the adequacy of the recipient actions cited in those records. This type of documentation is critical because each of the agencies we reviewed relied heavily on program, regional, or field offices to ensure that corrective actions occurred, yet none required reporting on the corrective action status of all single audit findings. We believe that the follow-up efforts should be documented and that doing so is a key to ensuring that agency offices perform their responsibilities to help ensure that recipients take all necessary corrective actions.

Single audits provide valuable information that agency managers can use to make operating decisions, monitor performance, and allocate resources. However, discussions with officials at each of the three agencies revealed that, even when program or other offices had information on single audit results and recipient actions to correct single audit findings, this information was not communicated to top-level agency management for review, analysis, and possible action. This reporting can strengthen accountability and oversight by providing management with information useful in the analyses of both programwide problems and recurring problems at specific recipients. Further, it can provide management officials with information relevant to agency efforts to reduce improper payments—a key element of *The President's Management Agenda, Fiscal Year 2002*, initiative to improve financial performance.

The report we are issuing today contains recommendations that call for the following actions by the Secretaries of Education, HUD, and Transportation.

- Ensure that the agency has established and follows guidance to address the OMB Circular A-133 requirements for all agencies whose awards are subject to the Single Audit Act, as amended. This guidance should address areas such as (1) preparing and issuing timely management decisions that clearly communicate the results of agency analyses of single audit findings and the adequacy of corrective actions implemented or planned by the recipient, (2) performing follow-up procedures to ensure that the recipient implemented adequate corrective action on a timely basis, and (3) documenting the results of evaluations of and conclusions on recipients' actions to correct audit findings.

-
- Implement policies and procedures for reporting information to top-level agency management on the (1) types and causes of findings identified in single audit reports and (2) status of corrective actions.

Other Single Audit Issues

Aside from the federal agencies' responsibility for taking all necessary actions to ensure that recipients implement timely and appropriate corrective actions to fix single audit findings, a number of other single audit-related issues exist. These include questions about whether

- all required single audits are conducted,
- recipients perform the required monitoring of subrecipients' uses of federal awards and follow up to ensure that they take timely and appropriate corrective actions on audit findings, and
- all single audits comply with government auditing standards.

The Single Audit Act, as amended, requires audits by recipients that expend \$300,000 or more in federal awards during the fiscal year. Currently, the federal government does not know or have a method for determining the universe of recipients and subrecipients that meet this \$300,000 threshold. In general, while the federal government does have disbursement systems that can identify amounts the federal government awards recipients, it does not have a system or systems to accumulate, track, and report on amounts actually expended by award recipients and subrecipients across the federal government. As a result, it is not possible to determine whether required single audits occur, identify recipients and subrecipients that have not had required single audits, or develop adequate follow-up systems to ensure that all required audits occur. Thus, in many respects, what we have is an honor system as to which recipients are arranging for single audits.

This information on the audit universe is important if federal agencies are to have any assurance that recipients and subrecipients receiving federal awards are receiving the required audits of their financial and internal control systems and of their compliance with applicable program laws and regulations. In addition, by ensuring that all required audits are conducted, federal managers will receive more complete information on audit findings useful in their governmentwide, agencywide, and recipient-specific analyses of single audit results and the \$325 billion in federal awards.

Under OMB Circular A-133, federal agencies are to receive single audit reports with findings relating only to award recipients that received federal awards directly from the agencies. When these recipients, such as states, forward awards to subrecipients such as municipalities, counties, or local governmental units, it becomes the recipient's responsibility under the circular to make sure that the subrecipients obtain single audits and that they take appropriate action to correct single audit findings.

A review of the Federal Audit Clearinghouse database³ for calendar year 2000 showed about 380 cases where the auditors reported that award recipients were not adequately monitoring their subrecipients to ensure that they complied with all of the requirements of the Single Audit Act, as amended. While a very small percentage of the total single audits, these cases can be significant because they often represent recipients that receive large amounts of federal awards, such as states, and pass those awards to subrecipients for program performance purposes. Therefore, it is very important for federal agencies to have assurances that the recipients take actions to ensure that their subrecipients take appropriate and timely actions to correct all single audit findings. Currently, federal agencies do not receive information on recipients' evaluations of and conclusions on the appropriateness of subrecipient actions to correct findings identified in single audit reports. This information is important from a program management standpoint because it could identify areas where the federal government needs to increase its oversight efforts or develop and issue guidance for recipient and subrecipient use when participating in federal programs and using federal awards.

Single audit quality has been a long-standing area of concern and one about which questions have surfaced since the passage of the Single Audit Act in 1984. In this regard, OMB Circular A-133 requires that cognizant agencies (i.e., those agencies with specific single audit oversight responsibilities for recipients expending more than \$25 million annually in federal awards) conduct or obtain quality control reviews of selected single audits.

³The Federal Audit Clearinghouse single audit database was established as a result of the Single Audit Act Amendments of 1996 and contains summary information on the auditor, the recipient and its federal programs, and the audit results.

Quality control reviews are reviews of the audit work supporting an individual audit assignment. They are performed by reviewing the independent auditor's working papers. In our recent survey,⁴ which we conducted at your request, respondents reported that federal agency inspectors general from 10 agencies participated on 109 quality control reviews during fiscal year 2000. However, this total may be overstated since offices of inspectors general occasionally perform joint reviews and our survey did not capture information on the extent of these collaborative efforts. The survey responses noted that the reviews identified a range of audit problems including those involving internal control and/or compliance testing performed by the auditors and auditor compliance with government auditing standards. While this limited information on the current audit quality problems cannot be used to project to or judge the quality of all single audits performed, it at least raises the possibility that problems continue to exist. OMB and federal agencies have recognized this potential problem, but a solution or approach to evaluating the overall quality of single audits conducted and developing a methodology to address all problems identified has not yet been developed.

Mr. Chairman, this concludes my statement. I would be happy to answer any questions you or other members of the subcommittee may have.

Contact and Acknowledgments

For information about this statement, please contact Sally Thompson, Director, Financial Management and Assurance, at (213) 830-1065 or at thompsons@gao.gov. Individuals who made key contributions to this testimony include Tom Broderick, Marian Cebula, and Perry Datwyler.

⁴U.S. General Accounting Office, *Single Audit: Survey of CFO Act Agencies*, GAO-02-376 (Washington, D.C.: Mar. 16, 2002).

Mr. HORN. We now have the second presenter, the Honorable Mark W. Everson, Controller, Office of Management and Budget.

STATEMENT OF MARK W. EVERSON, CONTROLLER, OFFICE OF MANAGEMENT AND BUDGET

Mr. EVERSON. Thank you, Mr. Chairman. I have a statement that goes on at some length on these issues, but I will just try to summarize it for you.

I think first I want to say obviously the issues that GAO has raised are significant and need to be addressed.

Mr. HORN. Without objection, we'll have your complete statement as if you read it, and go ahead on the summary.

Mr. EVERSON. Just picking and choosing from it, I'll try and hit the high points.

I think the reference you made to statutory changes that were made in 1996, we think clearly they're having a positive effect, but more needs to be done in terms of improving the audit quality, in terms of—as I'm sure my fellow panelists will say—using—furthering the use of technology to get better data. And I would just suggest that the progress has, however, been considerable, and it's—it must be considerable, because as you've pointed out, over \$300 billion of the expenditures, the outlays of the government, now come in the form of these grants. In fact, it's something that I was rather startled when I came back into government to learn that it's actually a larger number than procurement. The money that is expended through grants exceeds procurement.

I think we have a chart that just shows where—the pie chart indicates just how much goes into grants. Actually in terms of—outlays for fiscal year 2001 exceeded the money spent on the national defense by almost \$10 billion.

If you look at that, it's actually growing as well, principally because of the increase in the Medicaid payments, but it's actually increased from 11 percent of total outlays in 1990 to 17 percent in 2001. And we would expect that this figure would grow as time goes on, making it all the more important that we have appropriate financial controls and are looking at how these moneys are expended.

Right now the—this is an area where we are dependent, as in much of the administration's initiatives to control erroneous payments, on the efforts of States in particular. They are the largest grantees. In fact, if you look at just the top five States, they receive as grantees about half of this \$320 billion. So you've got California, New York, Texas, Illinois and Florida that constitute half of the recipients for these moneys.

We are looking at the audit threshold right now. The audit is required for any grantee over \$300,000. We're looking at whether we ought to increase that level. It would not in any way, shape or form do anything to reduce the dollar coverage, but it would reduce the burdens. Audits are obviously costly.

As was mentioned by Ms. Thompson, the management initiatives—the President's management initiative to reduce erroneous payments targets this very area. We need to do more, particularly with the three departments that have been mentioned, because if you look at the expenditure, the moneys, and you slice it not by

grantee, but you slice it by programs, there are 665 programs that are the vehicles for this funding, and the largest three are as mentioned. Health and Human Services has almost \$200 billion; again, Medicaid being a big piece here. But Transportation and HUD are also quite large, with about \$40 billion at Transportation, almost 30- at HUD. So we need to attack it both on a grantee basis, that is to say, where the money goes, but also, as was indicated, on a management basis of the very clear programmatic and accountability responsibility.

We do think the audits are having a result. There are clear cases where moneys have been recovered. An example of that would be when Aid to Families With Dependent Children—when that was folding down, the audits actually indicated problems in over \$20 billion—pardon me, \$20 million was—of overpayments that hadn't been provided or given back to the government, that was secured through just this very vehicle. So they're clearly a good thing.

I guess in closing I would also emphasize the need for improved audit quality. Our own indications, based on the work that's been done by IGs, are that this is spotty. It's not as consistent as it ought to be. It seems this is the season to question audits in general. It's, I guess, not surprising that more needs to be done in this very critical area as well. And I'll leave it at that.

Mr. HORN. Well, thank you.

[The prepared statement of Mr. Everson follows:]

**Statement of the Honorable Mark W. Everson,
Controller, Office of Federal Financial Management, Office of Management and Budget
before the**

**House Subcommittee on Government Efficiency,
Financial Management, and Intergovernmental Relations**

June 26, 2002

Introduction

Thank you, Mr. Chairman, for the opportunity to appear before you on a topic that is so important to the success of our efforts to improve the Federal government's financial performance, the Single Audit Act. The Single Audit Act was designed to ensure the integrity of the manner in which we choose to distribute hundreds of billions of Federal program dollars annually. It has as its basic requirement that if you receive Federal dollars, you should be audited on a regular basis. Today, there are thousands of audits conducted in every corner of this country that give us assurance that almost all Federal grant dollars receive some level of scrutiny. In fact, current data indicate that over 95 percent of Federal grant dollars are audited under the Single Audit Act. The American people deserve to know that their investment in the Federal government is not being squandered and that it is achieving its intended purpose.

Since Congress amended the Act in 1996, we have made great strides in improving the single audit process by standardizing and streamlining Federal grant audit policies, establishing an on-line database of single audit results, and maintaining an up-to-date Compliance Supplement to assist auditors in identifying the most important aspects of Federal programs to audit. However, in the spirit of continuous improvement, we recognize that there are several areas - - including more effective follow-up on audit findings and assessing single audit quality - - that need the Administration's attention to get the most out of single audits and achieve the underlying objectives of the Act. The audits conducted under the Act are surfacing important issues. Ideally, once these issues surface, an agency should determine the extent to which the issues are systemic and take action to resolve them. This happens in many cases. However, as you will hear from the General Accounting Office, there is evidence that audit findings are not receiving adequate attention. Audit quality is another area where we have reason to be concerned. We will work through the Chief Financial Officers Council and our other partners in the Federal grants management community to improve the Act's implementation. This is an important component of our accountability to the American people.

Magnitude of Federal Grants

Before discussing single audits, it is important to understand the magnitude of Federal grants and corresponding levels of audit coverage. As Chart 1 illustrates, a large portion of the Federal budget is expended each year through Federal grants to States, local governments, and non-profit

organizations – over \$317 billion, or 17 percent, of total Federal outlays for FY 2001. Mr. Chairman, that is more than we spent to defend this great country of ours last year. And we expect Federal grants to continue growing in future years. In fact, Federal grants as a percentage of total Federal outlays grew steadily, from about 11 percent in 1990 to 17 percent in 2001, and we expect future growth to about 18 percent of total Federal outlays by 2007. Chart 2 depicts this upward trend. The increase in Federal grants is principally attributable to the growth of the Medicaid program, which increased from about \$41 billion in 1990 to \$129 billion in 2001, and we estimate \$225 billion in Medicaid outlays in 2007.

The performance of the Federal government, especially in the area of grants, hinges largely on the extent to which its partners -- States, local governments, and non-profit organizations -- have good financial management practices themselves. Medicaid depends on States health care costs on behalf of the nation's poorest citizens. The School Lunch program is administered by States and local school districts -- and schools themselves -- throughout the country. The National Science Foundation sponsors some of today's most promising scientific research. With the diversity of the government's partners comes a great deal of financial risk.

The principal tool used by the Federal government for over 15 years to mitigate risk is the single audit process. Currently, we require entities that receive \$300,000 or more in grants to subject their organizations to audit. This means that more than 95 percent of Federal grants are audited under the Act. In a moment, I will make the case that we ought to raise the threshold for audits of grant recipients, which is one of several efforts the Administration is taking to make single audits more efficient and effective.

President's Management Agenda

As you know, the President has outlined an ambitious agenda to improve the management of the Executive Branch. He chose to focus attention on those management challenges where the opportunity to improve is the greatest: Human Capital, E-Government, Competitive Sourcing, Budget and Performance Integration, and the one we are focused on today, Improved Financial Performance. As you also know, we measure an agency's progress in achieving the goals of the Improved Financial Performance initiative against criteria on the Executive Branch Management Scorecard. An agency must meet all of these criteria to get a "green" score.

Part of the President's Management Agenda is also an effort to track and reduce erroneous payments in the government's many benefit programs. The Members of this Subcommittee know this problem well. Many programs do not have sufficient controls in place to prevent payments to ineligible program participants. The Department of Housing and Urban Development reports erroneous payments in its rental subsidy programs of more than \$3 billion. Single audits are the first line of defense against erroneous payments in these and other grant programs. Single audits also serve to identify problems in program design and implementation issues across programs.

Single Audit Results - Source of Valuable Information

Single audit results are entered into a national database so we can track audit findings by program, state, or grantee. The database, called the Federal Audit Clearinghouse, is on-line and

makes information from single audit reports nationwide available to the public in a consistent and comparable format. It provides a simple and convenient way for grantees to submit required reports to the Federal government as required by law. More importantly, it provides a one-stop portal to access some of the rich information that these reports provide. State and local governments, non-profit organizations, Federal agencies, and the American people have access to audit findings on most of the Federal programs operating within the United States. This is exactly the kind of transparent accountability that we need more of in Federal financial management.

The School Lunch program, for instance, provides support to serve breakfast, lunch, snacks, and dinner to children in participating schools, including free or reduced price meals to children whose households meet income eligibility criteria. This is a compassionate program with a worthy purpose: feeding the nation's hungry children. It operates in nearly 98,000 public and non-profit schools and residential child-care institutions. When the number of children certified for free meals grew in the 1990s, even as unemployment declined and participation in other means-tested programs dropped sharply, the Department of Agriculture suspected that many of the program's participants were ineligible to participate. This suspicion was supported by single audit results which showed lack of follow-up on verifications of free and reduced price applications. School food authorities are required to verify income eligibility on a sample of applications; however through a program design flaw, results of these verifications were not reported to States or the Department of Agriculture.

Based on its suspicion that there might be systemic problems with eligibility determination nationwide, the Department of Agriculture piloted a series of demonstration projects to assess the extent of the problem. These demonstrations suggest that anywhere from 18 to 29 percent of children certified for free meals may be ineligible.

As a result of this recent study, the Administration will propose regulations requiring school districts to report the results of verification to the Department of Agriculture. We will determine the source of this problem and fix it, without overburdening schools with red tape or barring needy children access to nutritious meals. We are committed to getting to the bottom of this problem, because many Federal, State, and local programs rely on school lunch certification information to allocate funds. Accurate information is critical to ensuring that dollars targeted to low-income children reach the correct schools and children.

Another example of using single audit results relates to the former Aid to Families with Dependent Children program. Many States simply retained overpayments made in this program which should have been returned to the Department of Health and Human Services. As a result of single audit findings, the department's Office of Inspector General initiated reviews in many States which have resulted in recoveries of over \$20 million. The Office of Inspector General estimates that full recovery could be double this amount.

Yet again, under Medicaid program requirements, State agencies must conduct information technology system security reviews over the Medicaid systems (e.g., eligibility and payments systems). This requirement was first listed for auditors to test in 1997 in the Office of Management and Budget's first Compliance Supplement under the revised Circular A-133.

Auditors initially cited many compliance problems for which States have taken corrective action and this is no longer a significant problem area. Single audit findings resulted in States addressing information technology security issues well in advance of many Federal agencies and private sector entities.

These are examples of what can be done with single audit data. It can provide us with sufficient information to determine major flaws in program administration or design that not only put tax dollars at risk, but severely hamper a program's chances of success.

Is the Information Being Used?

Mr. Chairman, you will hear more from those who operate the clearinghouse on behalf of the Administration. But our records on access to the website where the information is available show that some agencies are accessing the Federal Audit Clearinghouse database with increasing frequency. Hits for the purpose of entering information from audits have increased sharply, from 32,000 in FY 2001 to 80,000 in just the first 8 months of FY 2002. More significantly, from a financial performance standpoint, was the increase in access to the database by users who were seeking information on audits available on-line. Such access nearly doubled, jumping from 1,400 hits to 2,600 over the same time period. And thanks to our friends at the Clearinghouse, we can take a peek at which Federal agencies are making use of this very important data. The top Federal agency users of the Clearinghouse's Internet Dissemination System in FY 2001 were the following: the Departments of Justice, Housing and Urban Development, Health and Human Services, and the Interior; the Corporation for National and Community Service; the Environmental Protection Agency; the National Science Foundation; and the General Accounting Office. But we are clearly not using the information gleaned from single audits to its full advantage.

The General Accounting Office is reporting today that several agencies, namely the Departments of Education, Housing and Urban Development, and Transportation, are not doing enough to address findings identified by single audits. In its investigation, the General Accounting Office learned that the agencies could not provide sufficient documentation to show that they had even followed up on 171 of 246 substantive findings. The best effort was in the Pell Grant program, which offers higher education student financial assistance. As you know, there is a documented erroneous payment problem with the Pell Grant program. The least impressive effort to follow up on audit findings was in the Department of Transportation's Highway Planning and Construction Grants program. This is a weakness that must be remedied. I am glad to say the department has recently instituted a recovery audit program to assess the extent of erroneous payments in the Highway Planning and Construction Grants program. This should be just one part of identifying areas of concern in programs and following up to ensure they are corrected.

I fully support the General Accounting Office's recommendations to reinforce our current procedures for following up on single audit findings. The General Accounting Office rightly points out that use of single audit data could be a useful tool to identify causes of erroneous payments, a priority on the President's Management Agenda. The Office of Management and Budget, working with the Chief Financial Officers Council, the Federal grants management community, and the Federal Audit Clearinghouse, will step up training and outreach efforts so

that program managers are aware of, and make better use of, audit results and other available information to oversee Federal grant programs. The basic information infrastructure is in place -- now, we need to make sure that the information is used to actively improve Federal grant programs.

Audit Quality

Clearly, if we rely on single audits to buttress Federal accountability and for audit follow up to be valuable, the audits must be thorough and reliable in the first place. Recent reviews raise concerns with the quality of audits conducted pursuant to the Single Audit Act. These reviews, called Quality Control Reviews, are performed by Federal agencies. Some have identified significant audit quality problems and these may be pervasive. For example:

- The Departments of Health and Human Services and Education Offices of Inspector General have found auditors are not properly selecting the Federal programs to be tested during a single audit. The result is that Federal programs which should have been tested were not. The Department of Health and Human Services has already referred over 35 auditors to professional bodies for possible disciplinary action and is currently considering additional referrals. The Department of Education is following up to require corrective action for programs not tested.
- The Department of Labor Office of Inspector General reviewed six audits and found that auditors did not perform adequate tests in a majority of these cases, and in some cases gathered no evidence at all for specific compliance requirements. (This report on these reviews is available on the Internet at www.oig.dol.gov/public/reports/oa/2002/22-02-011-50-598.pdf)
- The Department of Housing and Urban Development Real Estate Assessment Center performs quality control reviews on Housing Authorities. The Center reportedly completed 66 quality control reviews of 14 independent auditors. As of September 30, 2001, 35 percent of the auditors (and possibly more) did not perform adequate testing in accordance with the Compliance Supplement.

We believe these specific examples of audit quality problems are significant. However, since the selection of audits for quality control review is not statistically-based, we do not know whether the problems noted significantly diminish Federal grant-making agencies' ability to rely on single audits to ensure accountability for Federal grants. We need an accurate measure of audit quality and it needs to be statistically based. The measure needs to include both a baseline of the current status and the means to monitor quality in the future.

We recognize the importance of garnering and coordinating Federal resources to assess single audit quality. The Office of Management and Budget, working through the Chief Financial Officers Council and the Grants Management Committee, will establish an inter-agency, interdisciplinary task force to assess single audit quality. The task force will develop a statistically-valid measure of current single audit quality. This task force will consult with the General Accounting Office, the Offices of Inspector General, the National State Auditors Association,

and other single audit constituents. Also, the plan will include a follow-up process to improve and monitor audit quality over time. The Office of Management and Budget anticipates agencies will be in place to begin measuring the quality of audits submitted to the Federal Audit Clearinghouse during 2002.

Focus Audits Where Federal Risk Is Greatest

As I mentioned earlier, the Office of Management and Budget is working toward increasing the audit threshold amount from \$300,000 to \$500,000. The Single Audit Act provides for the Director of the Office of Management and Budget to review the single audit threshold and increase it as appropriate. The current audit threshold requires all grantees that expend \$300,000 or more in a year in Federal awards to have an audit conducted in accordance with Circular A-133. As shown in the following table, an audit threshold increase from \$300,000 to \$500,000 would relieve 6,000 entities from the audit requirements of Circular A-133 while retaining audit coverage for 99.5 percent of Federal awards currently audited (in dollars). Raising the threshold makes sense, as it reduces the burden on smaller non-Federal entities and concentrates scrutiny where the Federal risk is the greatest.

| <u>Federal Awards Expended Range</u> | <u>Number of Entities Audited</u> | <u>Percent of Entities Audited</u> | <u>Percent of Federal Awards Expended Within Range</u> |
|--|---|--|--|
| \$300,000 to \$500,000 | 6,000 | 18% | .5% |
| \$500,000 and above | 28,000 | 82% | 99.5% |
| Total | 34,000 | 100% | 100.0% |

Administration Actions

In 1996, Congress wisely enacted the Single Audit Act Amendments of 1996. At that time, studies of the single audit process performed by the General Accounting Office, the President's Council on Integrity and Efficiency, and the National State Auditors Association cited the need for a regularly updated Compliance Supplement, the Federal government's road map to the auditors on the key compliance requirements which auditors should test. The National State Auditors Association study stated: "The Compliance Supplement provides an invaluable tool to both Federal agencies and auditors in setting forth the important provisions of Federal assistance programs. This tool allows Federal agencies to effectively communicate items which they believe are important to the successful management of the program and legislative intent . . . Such a valuable tool requires constant review and update."

Since 1997, the Office of Management and Budget annually has updated and enhanced the Supplement which now provides guidance on over 150 Federal programs with the assistance of Federal grant-making agencies. We recently undertook an exhaustive update of the Compliance Supplement, and I have provided it to the Members of this Subcommittee on CD-ROM. In

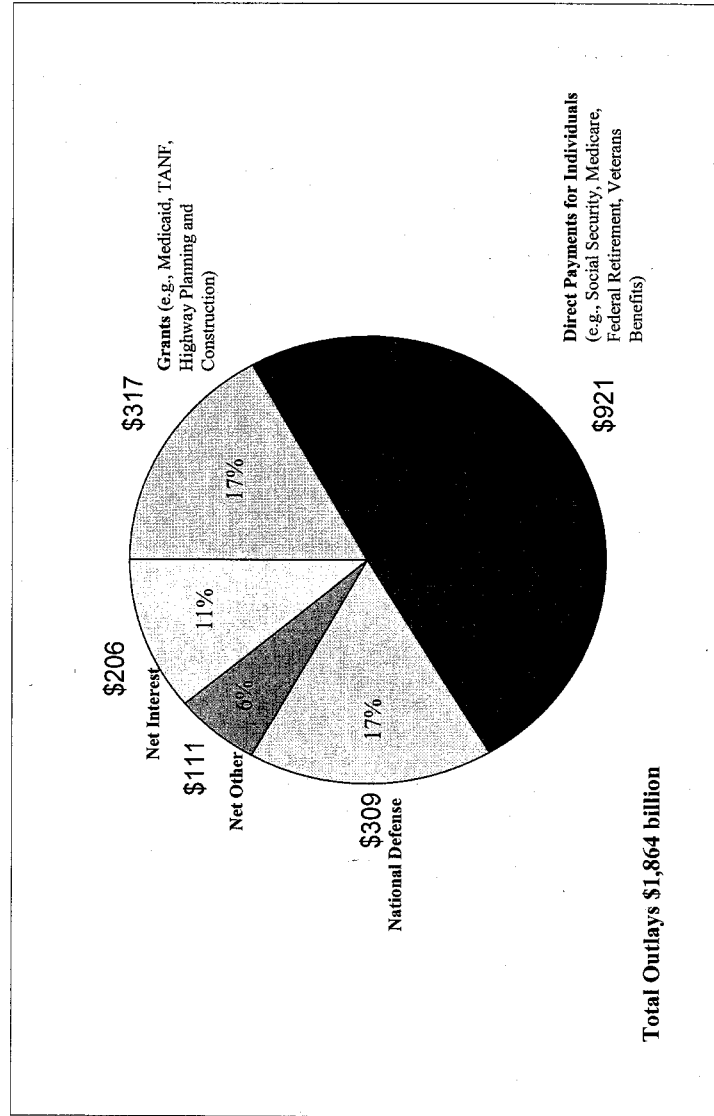
addition to providing detailed guidance to auditors throughout the nation, the Supplement gives descriptions of the many Federal programs that are administered on behalf of the Federal government and the eligibility and other requirements for participation in the programs. Without this Supplement, auditors of over 34,000 entities would each have to research the many laws and regulations governing each program under audit to determine which compliance requirements are important to the Federal government and could have a direct and material effect on a program's financial performance. The Supplement is a source of information for auditors to understand the Federal program's objectives and suggested audit procedures for determining compliance with these requirements.

We will continue to update this important resource annually, providing the guidance necessary to ensure that our tax dollars are audited efficiently and effectively. And like in the past, where we find evidence that the Single Audit Act implementation is flawed, we will work to correct those flaws. We are taking actions to ensure that findings are addressed and audit quality is ensured. In addition, we will continue our work to raise the audit threshold from \$300,000 to \$500,000.

As I have stated, the Single Audit Act provides the Administration, Congress, and the American people assurance that States, local governments, and non-profit organizations that administer Federal programs are being scrutinized. These parties are an important component of the Federal government's efforts to serve the American people and demonstrate accountability over Federal tax dollars. These audits allow us, to some extent, to determine whether our programs are meeting their goals. While we believe the single audit process is working well, we have identified key areas that warrant attention – audit quality, making better use of single audit results, and increasing the audit threshold – so that the underlying objectives of the Act will be achieved. This Administration is committed to addressing these areas to strengthen single audits in the future and ultimately improve the administration of Federal grants.

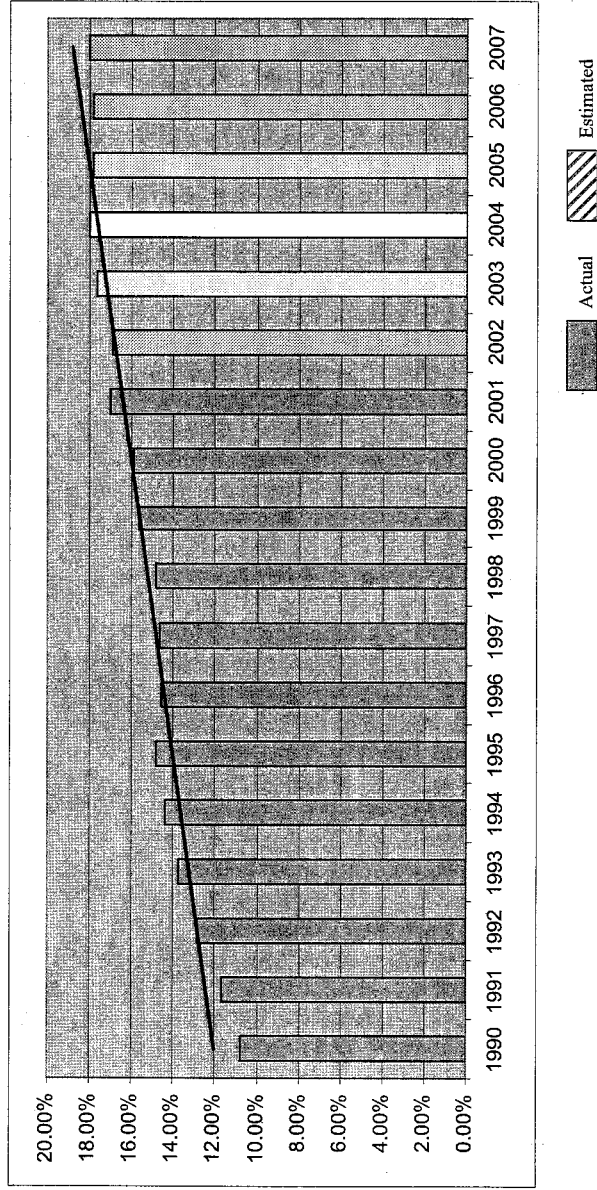
Thank you, Mr. Chairman. I look forward to answering your questions.

Composition of Federal Outlays: FY 2001 Chart 1
(billions)



Source: Historical Tables, Budget of the United States Government, Fiscal Year 2003

Grants as a % of Total Federal Outlays **Chart 2**
1990 - 2007



Source: Historical Tables, Budget of the United States Government, Fiscal Year 2003

Mr. HORN. Our third presenter is Frederick T. Knickerbocker, the Associate Director for Economic Programs of the U.S. Census Bureau.

STATEMENT OF FREDERICK T. KNICKERBOCKER, ASSOCIATE DIRECTOR FOR ECONOMIC PROGRAMS, U.S. CENSUS BUREAU

Mr. KNICKERBOCKER. Mr. Chairman, thank you for the opportunity to testify this morning. OMB Circular A-133 designates the Bureau of the Census as the Federal Audit Clearinghouse. The clearinghouse provides an efficient and effective method of processing, distributing and archiving Single Audit reports, monitoring recipients' compliance with the requirements to submit reports required by the act, and capturing and analyzing information on audit results.

The clearinghouse reduces the costs of the audit process in a number of ways. First, the central election function allows grantees to send reports to one location instead of reporting to each agency that provided grant funding. Next, the clearinghouse distributes only the reports grant-making agencies need to followup on audit findings. The clearinghouse also facilitates the identification of those organizations that did not submit required audits. And finally, the central clearinghouse provides important government-wide audit information that was previously not available to Congress, OMB and agency program managers.

Establishing the clearinghouse, one, reduces the reporting burden on non-Federal entities and, two, the number of reports that Federal agencies must process.

The clearinghouse operates under the direction of OMB with input from the Federal agencies through a user's group and non-Federal auditors. In fiscal year 2002, the clearinghouse operated with a \$2.6 million budget. All of these funds are provided by the 24 Federal agencies included in the Chief Financial Officers Council.

The clearinghouse began processing data collection forms in December 1997. It now processes approximately 35,000 submissions each year. To date, the clearinghouse has processed approximately 150,000 data collection forms and reporting packages.

The clearinghouse is currently working with OMB and members of the Audit Oversight Workgroup of the Chief Financial Officers Council on a delinquent audit plan. In July 2001, the clearinghouse performed a nonresponse followup test. The goal of the test was to determine whether efforts made by the clearinghouse would result in a significant number of additional submissions. The test results demonstrated that a marked improvement in the response rate is possible. The Chief Financial Officers Council is using these results to develop a governmentwide plan to identify delinquent single audits.

The clearinghouse maintains a governmentwide data base covering all complete data collection form data. The data base is accessible to Federal agency users and the public through an Internet site maintained by the Census Bureau.

Federal agency representatives made several requests for enhanced capabilities of the clearinghouse's Internet Data Dissemination System. Some of these requests resulted from efforts of the

Chief Financial Officers Council to meet the requirements of the Federal Financial Assistant Management Improvement Act of 1999. These results resulted in several improvements to the clearinghouse data dissemination system.

The data base for all completed submissions now approaches 150,000 records and is available through the Census Website.

The clearinghouse has also developed several electronic options to ease the reporting burden. Larger entities have expressed concerns over the burden of reporting on hundreds of programs, and in response we created a processing method to allow larger entities to submit all their data on spreadsheets and, therefore, to the clearinghouse via diskette. Much more importantly, however, this clearinghouse has developed an Internet data entry system. The system allows entities to enter, edit and submit all data electronically. The clearinghouse started Internet reporting in early 2000. Now approximately 60 percent of all submissions are reported online.

Since the clearinghouse is the single submission point for nearly all audit reporting packages, Federal agencies generally no longer receive copies of the audit reports directly from auditees. The clearinghouse, however, currently maintains an archive of the current-year audit reports and those for the 4 prior fiscal years. Requests for copies of reporting packages are received daily. Those from Federal awarding agencies are processed immediately. Public requests for copies of audits requires special attention due to the possible presence of sensitive data such as the names of individuals and Social Security numbers.

For requests from non-Federal entities, the clearinghouse staff locates and copies the audits, and our Freedom of Information Act Office forwards them to the relevant agency for review and distribution. To assure outside consultation on this whole operation, a Single Audit Users Group was formed with representatives from the Federal grantmaking agencies, OMB, GAO, the clearinghouse, the public sector and private accounting firms, and this group has been meeting periodically since 1997.

That concludes my testimony. I'd be happy to answer any questions.

Mr. HORN. Thank you.

[The prepared statement of Mr. Knickerbocker follows:]

PREPARED STATEMENT OF
FREDERICK T. KNICKERBOCKER
ASSOCIATE DIRECTOR FOR ECONOMIC PROGRAMS
U.S. BUREAU OF THE CENSUS
Before the Subcommittee on Government Efficiency, Financial
Management and Intergovernmental Relations
Committee on Government Reform
U.S. House of Representatives
June 26, 2002

Mr. Chairman, Congresswoman Schakowsky, and Members of the Subcommittee:

It is a pleasure to appear before you to testify at this hearing on the Single Audit Act.

Purpose

To begin, let us refresh our memory as to what the Single Audit Act (Act) is all about. The purpose of this Act is to: (1) improve the effectiveness and performance of Federal financial assistance programs; (2) simplify Federal financial assistance application and reporting requirements, particularly auditing requirements; (3) improve the delivery of services to the public; and (4) facilitate greater coordination among those responsible for delivering such services. The Census Bureau's Federal Audit Clearinghouse contributes to improvements in each of these areas.

The Single Audit Act Amendments of 1996 (Public Law 104-156) requires the Office of Management and Budget (OMB) to designate a Federal clearinghouse to receive copies of reports required by the Act and identify recipients who failed to submit the required audits. OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, designates

the Bureau of the Census as that clearinghouse. The Clearinghouse processes incoming reporting packages and related data collection forms, maintains a governmentwide database of audits, distributes reports with audit findings to individual Federal agencies for audit resolution, and maintains an archival copy of all reports. The Clearinghouse provides an efficient and effective method of: (1) processing, distributing, and archiving Single Audit reports, (2) monitoring recipients' compliance with the requirement to submit reports required by the Act; and (3) capturing and analyzing information on audit results.

The Clearinghouse reduces the costs of the audit process in a number of ways. First, the central collection and distribution function allows grantees to send reports to one location, instead of reporting to each agency that provided grant funding. Without the Clearinghouse, each grantmaking agency would be required to devote resources to maintain systems to process audit reports submitted by grantees. Next, the Clearinghouse distributes only the reports grantmaking agencies need to follow-up on audit findings. This allows agencies to focus their efforts on grantees that are of concern. The Clearinghouse also facilitates the identification of those organizations that did not submit required audits, and thus enables agencies to more efficiently address problem issues. Finally, the central Clearinghouse provides important governmentwide audit information that was previously not available to Congress, OMB, and agency program managers.

Prior to the Act and the revised Circular A-133, non-Federal entities (States, local governments, and non-profit organizations) submitted their Single Audit reports to each of the Federal agencies providing direct funding. Each agency separately processed these reports. Establishing the Clearinghouse reduces (1) the reporting burden on non-Federal entities, and (2) the number of reports that Federal agencies must process (generally agencies only need to act on reports with audit Clearinghouse findings). It also provides a central database of audits, which is the only governmentwide monitoring system for the audits of the more than \$350 billion in annual Federal awards.

The Clearinghouse operates under the direction of the OMB, with input from the Federal agencies through a user's group and non-Federal auditors. In Fiscal Year 2002, the Clearinghouse operated with a \$2.6 million dollar budget and 32.5 FTE staff. All of these funds are provided by the 24 Federal agencies included in the Chief Financial Officers Council.

Single Audit Processing

The Clearinghouse began processing data collection forms in December 1997. It now processes approximately 35,000 submissions each year. To date, the Clearinghouse has processed approximately 150,000 data collection forms and reporting packages (audits and financial statements) submitted under revised OMB Circular A-133. Three attachments to my written testimony provide details on the status of submissions for FY 1997 through FY 2001 and copies of the current version of the government's audit reporting form (Form SF-SAC) and the special instructions accompany the reporting form.

Nonresponse Follow-up

The Clearinghouse is currently working with OMB and members of the Audit Oversight Workgroup of the Chief Financial Officers Council on a Delinquent Audit Plan. In July 2001, the Clearinghouse performed a nonresponse follow-up test to assist work being performed on behalf of the Audit Oversight Workgroup. The goal of this test was to determine whether efforts made by the Clearinghouse would result in a significant number of additional submissions. The test results demonstrated that a marked improvement in the response rate is possible. The Chief Financial Officers Council is using these results together with information in other sources, such as those used for grant payments, to develop a governmentwide plan to identify delinquent single audits.

The Clearinghouse is now preparing to begin a new phase of work detailed in the Delinquent Audit Plan, where our staff will work with the Federal grantmaking agencies to match Clearinghouse records against those of the three Federal payment management systems. These systems are operated by the Department of Health and Human Services, the Department of the Treasury, and the Department of Defense.

Governmentwide Database and Internet Site

The Clearinghouse maintains a governmentwide database covering all complete data collection form data. The database is accessible to Federal agency users and the public through the Internet at the following web site address: <http://harvester.census.gov/sac>. Our staff developed this data dissemination system with input from the Single Audit Users Group.

Federal agency representatives of the Single Audit User Group made several requests for enhanced capabilities of the Clearinghouse's Internet Data Dissemination System. Some of these requests resulted from efforts of the Chief Financial Officers Council to meet the requirements of the Federal Financial Assistance Management Improvement Act of 1999 (PL 106-107). These requests resulted in the Clearinghouse adding capabilities to its dissemination system, including: a more user-friendly menu; expanded query options; and viewable and downloadable spreadsheet options for handling data produced from custom queries.

The database of all completed submissions now approaches 150,000 records. A complete downloadable copy of the database is also available through the Census web site. This option is primarily used by organizations whose search criteria generate a large number of records.

The Clearinghouse also posts an in-progress file. This file identifies entities that have filed Circular A-133 submissions, which are still in various stages of processing or were rejected due to form errors and/or missing audit components.

The web site also contains a Summary Report of the number of database records, detailed by fiscal year with and without audit findings (deficiencies which the auditor is required to report). The summary report is organized by: Incomplete receipts, complete receipts with findings, and complete receipts without findings for each fiscal year.

Federal agencies can use the database to identify submissions reporting the use of funds for programs their agency administers. It can identify which of the various federal agencies providing funds to individual award recipients has primary oversight for Single Audit purposes.

These data can also quickly help Federal agencies identify and begin the resolution of audit findings associated with the Federal award funds expended under these programs.

Accessibility

In developing and maintaining the Clearinghouse web site, our staff were mindful of the requirements of Section 508 of the Rehabilitation Act of 1973. The primary purpose of Section 508 is to provide access to and use of Federal executive agencies' electronic and information technology by individuals with disabilities. We have done extensive work to get the web site to comply with both Section 508 and the Census Bureau's own accessibility standards.

Electronic Filing Options

The Clearinghouse developed the following electronic options to ease reporting burden:

Electronic Submission of Federal Award Expenditures, Findings, and Questioned Costs

Concerns were expressed over the heavy reporting burden of entering data on hundreds of Federal programs on a data collection form for larger entities. In response, the Clearinghouse created a processing method to allow larger entities to submit on a spreadsheet the list of Federal programs. This method provides a way for the auditees to download Federal program data from their internal financial database into a file, perform minor adjustments to allow the data to conform to specific technical parameters, and submit the data via a diskette.

Internet Version of Data Collection Form

In an effort to drastically cut the rate of report submission problems and to ease the reporting burden on auditees, the Clearinghouse developed an Internet data entry system. This system allows entities to enter, edit, and print all data electronically. The system ensures higher data integrity in the database by limiting the number of keying errors, reducing reporting burden and the rejection rate, decreasing processing time, and cutting costs.

When the form is complete, if edit failures still exist, only a draft copy prints. Once all edits have been resolved, a final copy of the data collection form prints at the entity's computer for signatures. Signed forms are then mailed to the Clearinghouse. A unique identifier code is

assigned by the system for use in processing Internet forms by the Clearinghouse. When the signed form is received, it is matched with the Internet data, and the Internet data are merged into the database. The audits are further processed and disseminated under regular procedures.

The Clearinghouse released this new submission option in early 2000. The form is accessible through the Census web site. During this first year of availability, approximately 10 percent of submissions were filed using the online option. The Clearinghouse is now entering the third year of Internet reporting availability and approximately 60 percent of 2001 submissions have been entered online. Once the electronic signature technology is refined, OMB may also opt to eliminate the parallel paper submission for these cases.

Access to OMB Circular A-133 Audits

Under revised Circular A-133, the Clearinghouse is the single submission point for nearly all audit reporting packages. Federal agencies generally no longer receive copies of the audit reports directly from auditees. The Clearinghouse currently maintains an archive of the current years audit reports and those for the four prior fiscal years.

Requests for copies of Circular A-133 reporting packages are received daily, and those from Federal awarding agency representatives are processed immediately. Public requests for copies of government audits and nonprofit organization audits require special attention, due to the possible presence of sensitive data, such as the names of individuals and Social Security numbers. For requests from non-Federal entities, the Clearinghouse staff locates and copies the audits, and our Freedom of Information Act Office forwards them to the entity's designated Federal cognizant or oversight agency for review and distribution.

Outside Consultation

Single Audit Users Group

A Single Audit Users Group was formed with representatives from the Federal grant making agencies, OMB, GAO, the Clearinghouse, and the public sector and private accounting communities. This group has met periodically between February 1997 and the present.

The objectives of the group are:

- Create a working group to test the Internet data dissemination system and provide feedback to OMB and the Clearinghouse
- Define Internet database requirements
- Define data dissemination system requirements and access procedures
- Coordinate nonresponse follow-up
- Serve as a forum to review topical issues and provide input to OMB and the Clearinghouse

Accounting and Auditing Community

The Clearinghouse staff actively participates in Federal, State, and national audit forums and professional accounting conferences. Presentations have consisted of discussions on reporting problems, explaining how to avoid them, and updates on any changes related to filing Circular A-133 submissions. These efforts have contributed to a substantial reduction in the rejection rate.

Conclusion

The Census Bureau's Federal Audit Clearinghouse continues to serve an important role in streamlining the grant management oversight and monitoring activities of the Federal Government. The Census Bureau will continue to work closely with the Office of Management and Budget, the General Accounting Office, the Federal grantmaking agencies, grant recipients, and the auditing and accounting community. Our collective efforts will help ensure the most efficient monitoring and reporting possible on the more than \$350 billion in annual Federal awards covered by the Single Audit Act.

That concludes my testimony and I will be happy to answer any questions.

Attachment 1**OMB Circular A-133 Filing Status as of May 13, 2002**

| | |
|---|--------------|
| Fiscal Year 1997 Status Report | |
| Completed w/o Findings | 19,983 |
| Completed w/Findings | 6,450 |
| <u>Rejected Receipts</u> | <u>1,463</u> |
| Total Processed Receipts | 27,896 |
| Fiscal Year 1998 Status Report | |
| Completed w/o Findings | 24,723 |
| Completed w/Findings | 7,274 |

| | |
|---------------------------------------|---------|
| <u>Rejected Receipts</u> | 971 |
| Total Processed Receipts | 32,968 |
| Fiscal Year 1999 Status Report | |
| Completed w/o Findings | 26,321 |
| Completed w/Findings | 7,078 |
| <u>Rejected Receipts</u> | 690 |
| Total Processed Receipts | 34,089 |
| Fiscal Year 2000 Status Report | |
| Completed w/o Findings | 27,339 |
| Completed w/Findings | 6,792 |
| <u>Rejected Receipts</u> | 957 |
| Total Processed Receipts | 35,088 |
| Fiscal Year 2001 Status Report | |
| Completed w/o Findings | 15,927 |
| Completed w/Findings | 3,073 |
| <u>Rejected Receipts</u> | 2,353 |
| Total Processed Receipts | 21,353* |

* The Clearinghouse is currently processing the 2001 submissions.

Mr. HORN. We have now the ranking member here, and she, too, will have to leave when I leave at 11, because she's in the financial business where they're always meeting.

Ms. SCHAKOWSKY. Well, we're in a markup.

Mr. HORN. Ms. Schakowsky, the gentlewoman from Illinois.

Ms. SCHAKOWSKY. I thank our distinguished panel, and I thank you, Mr. Chairman, for your leadership on financial management issues and for holding this hearing on the Single Audit Act.

The Single Audit Act is an important piece of legislation, because it both improves financial accountability and reduces the burden the Federal Government places on nonprofit agencies and local governments that are receiving Federal funds.

These audits provide the basis for public assurance that grant funds are being spent properly and at the same time allows these agencies to meet all audit requirements with a single annual audit.

There are a wide variety of agencies in the city of Chicago, part of which I represent, which come under the Single Audit Act from the Archdiocese of Chicago to the Chicago Antihunger Federation, to the Lincoln Park Zoo. I'm pleased that we have reduced the burden on these organizations and that we can account for the Federal funds spent.

However, I would like to challenge the auditors to look at these audits not simply as a review of the past, but an opportunity to help make these programs more effective.

I would like us to move beyond the concerns about recordkeeping and work toward a system that helps these agencies become more efficient in the delivery of services. We care about the Lighthouse Group or the Jewish Children's Bureau not because they're good recordkeepers, but because of the good work that they do.

I would like to see the auditors assist these agencies in streamlining their financial systems so that they can spend more time and more dollars on services and less on financial accounts. If we can use these audits to improve service delivery, we will have accomplished a very important goal.

Again, I thank you, Mr. Chairman, for holding this hearing, and the witnesses for your testimony.

Mr. HORN. Thank you.

And our next presenter is Russell W. Hinton, Chair of the Single Audit Committee of the National Association of State Auditors, Controllers and Treasurers. Mr. Hinton.

STATEMENT OF RUSSELL W. HINTON, CHAIR, SINGLE AUDIT COMMITTEE, NATIONAL ASSOCIATION OF STATE AUDITORS, CONTROLLERS AND TREASURERS

Mr. HINTON. Thank you, Mr. Chairman. I appreciate the opportunity to testify today on behalf of the National State Auditors Association regarding the Single Audit Act amendments of 1996. My testimony represents the combined views of the NSAA membership and does not necessarily represent the views of individual States and their implementation of the Single Audit Act.

A recurring theme throughout the amendment process was for the implementation of the single audit process to be dynamic, that processes and procedures reflect changing conditions. We feel that

the adoption of this concept will strengthen implementation of the single audit process significantly.

From a State perspective, critical to an ongoing single audit process is maintenance of OMB Circular A-133. Four areas that we consider critical that need to be addressed periodically would include updating of the OMB A-133 compliance supplement, review of the single audit threshold, authorization for review of pilot projects and continual update of the data collection form.

With regard to the OMB compliance supplement, the State audit community is very pleased with the efforts of OMB to update that document annually. It provides a wealth of information for those of us who are charged with the responsibility of auditing Federal programs.

With regard to the single audit threshold, the amendments would require OMB to review the threshold triggering the single audit biannually, and it is our current understanding that a proposal from OMB will be forthcoming, calling for an increase in the threshold from 300,000 to 500,000. NSAA will be supportive of such a proposal.

A few States opposing an increase in a threshold cite concerns relating to the monitoring of subrecipients. To the extent that additional subrecipients will no longer be covered under the Single Audit Act amendments of 1996, a particular State's monitoring efforts and audit costs may likely increase. There are—in conjunction with an increase in the threshold to \$500,000, the NSAA has agreed to participate in a working group proposed by OMB to develop methodologies to effectively and efficiently monitor subrecipients.

With regard to authorization of pilot projects, OMB may authorize pilot projects after consultation with appropriate Senate and House committees to test alternative methods of achieving the purposes of the amendments. It was envisioned that numerous pilot projects would be ongoing and would serve as a catalyst for future amendments to the Single Audit Act and A-133. Today the NSAA notes that the pilot project provision has not been fully utilized to explore alternatives. The NSAA remains supportive of the pilot project provision of the Single Audit Act amendments of 1996.

Several States indicate the single audit objectives and corresponding audit procedures do not adequately measure combined Federal-State-local program results, and several States believe it is time to transition the focus of single audits from compliance audits to alternative engagement types through the pilot project process; i.e., performance audits or total program engagements. The NSAA, therefore, encourages the OMB and other Federal grantor agencies to initiate or solicit proposals for worthy pilot projects and to give appropriate considerations to cost/benefit and timing issues.

With regard to single audit quality, the creation of sound single audit legislation does not—obviously does not guarantee a successful implementation. We believe that it's dependent upon a cooperative effort between both the Federal Government granting agencies and auditors.

With regard to management decisions, we are sometimes frustrated in the State audit community that while Federal awarding agencies have shown improvements in the timeliness in which they

address recipient audit findings, several States continue to be concerned that Federal awarding agencies are not operating at the optimum level with regards to the issuance of timely management decisions.

We applaud the creation and use of the Federal Automated Clearinghouse Data base. It's been an invaluable tool in monitoring overall audit quality from a State perspective. It provides a wealth of information to assist us in monitoring our responsibilities at the State level.

With regard to quality control reviews, NSAA considers quality control reviews to be one of the most effective means of ensuring accountability over the quality of audits conducted by non-Federal auditors. We would like to see an increase in this in conjunction with increased auditing efforts at the State level with regard to the quality of certain audits of smaller organizations. We note a large disparity in the quality of work being conducted at that level and feel that particular training and other efforts should be directed at auditees with regard to auditor procurement, because based on some of the research that we have done, we need a better grade of auditor at certain levels.

We would once again emphasize—I think one of the success stories of the 1996 amendment has been an increased cooperation on the part of the Federal, State and local government audit community, and we would certainly applaud those efforts going forward. Thank you.

Mr. HORN. Thank you.

[The prepared statement of Mr. Hinton follows:]



National State Auditors Association

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NASACT EXECUTIVE DIRECTOR

ALMOND P. VAN DANIKER
Lexington, Kentucky

Testimony of Russell W. Hinton
Chair, Single Audit Committee
National State Auditors Association (NSAA)
And
State Auditor of the State of Georgia

Before the House Government Reform Subcommittee
On Government Efficiency, Financial Management and
Intergovernmental Relations
June 26, 2002

The Single Audit Act Amendments of 1996

Mr. Chairman, and distinguished members of the Subcommittee, I am honored to have the opportunity to testify today on behalf of the National State Auditor's Association (NSAA) on the Single Audit Act Amendments of 1996. My testimony addresses the sufficiency of the Act to meet the needs of State governments and a progress report, from NSAA's perspective, on its implementation through Office of Management and Budget (OMB) Circular A-133, and the quality of single audits presently being conducted. My testimony represents the overall viewpoint of the membership of NSAA and does not necessarily represent the views of individual States. This testimony was the result of partnering with representatives of Federal, state and local governments on an ongoing basis.

Sufficiency of the Single Audit Act Amendments of 1996

Prior to the passage of the Single Audit Act Amendments of 1996, the objectives of the Single Audit Act were not being adequately achieved. The concept of the single audit is to provide the Federal government assurance that its recipients are properly spending Federal awards through an organization-wide audit process. Deficiencies in the design and implementation of the Single Audit Act of 1984 existed. Fortunately, these deficiencies did not go unnoticed. The process to bring about sweeping changes in the Single Audit Act began with the identification of the problems noted by key players in the audit process. Representatives from all facets of Federal, State and Local governments, Indian Tribes, Institutions of Higher Education, Nonprofit Organizations, as well as other independent auditors were made a part of the

due process to bring about needed changes to the Single Audit Act. Deliberations on draft proposals that resulted were exhaustive and resulted in amendments that seemingly rectified several fundamental problems that were found to exist.

The NSAA deems the Single Audit Act Amendments of 1996 and corresponding implementation regulation, Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, as a whole, to be sufficient to meet the needs at the State level. A primary reason for the Single Audit Act Amendment's enduring sufficiency is its built-in measures that allow for adjustments to be made to OMB Circular A-133 at appropriate intervals.

Maintenance of OMB Circular A-133

Proper maintenance of OMB Circular A-133 is essential to ensure that the objectives of the Single Audit Act Amendments of 1996 are met on an on-going basis. NSAA closely tracks and provides input each time a matter is considered for change. Those measures that require periodic update or action include, but are not limited to the following: (1) OMB Circular A-133 Compliance Supplement, (2) single audit threshold, (3) authorization of pilot projects, and (4) the data collection form.

OMB Circular A-133 Compliance Supplement

We applaud OMB and contributing Federal agencies for their efforts in ensuring that the Compliance Supplement is updated annually. Each year since the Amendments went into effect the number of programs included in the Supplement has increased. Other programs already in the Supplement are updated for changes on a regular basis.

Single Audit Threshold

The Single Audit Act Amendments of 1996 requires the OMB, every two years, to review the threshold triggering a single audit. Further, the OMB may adjust this amount provided the amount is not less than \$300,000. It is our understanding that a proposal from OMB will be forthcoming in the near future calling for an increase in the threshold from \$300,000 to \$500,000. Based on feedback received from State Auditors during the past year, NSAA will be supportive of such a proposal. The few States opposing an increase in the threshold cite concerns related to monitoring of subrecipients. The main drawback, they say, is that audits are a useful tool in monitoring subrecipients. To the extent that additional subrecipients will no longer be covered under the Single Audit Act Amendments of 1996, a State's monitoring and audit costs will likely increase. Therefore, in conjunction with an increase in the threshold to \$500,000, the NSAA has agreed to participate in a working group proposed by OMB to develop methodologies to effectively and efficiently monitor subrecipients.

Authorization of Pilot Projects

The OMB may authorize pilot projects, after consultation with applicable Senate and House committees, to test alternative methods of achieving the purposes of the Single Audit Act Amendments of 1996. Many States envisioned this provision of the Amendments as a means of experimenting with innovative ways of conducting single audits. It was further envisioned that numerous pilot projects would be on-going and would serve as a catalyst for future Amendments to the Single Audit Act and OMB Circular A-133. Today, the NSAA notes that the pilot project provision of the Single Audit Act Amendments of 1996 has not been utilized to explore alternatives.

The NSAA remains supportive of the pilot project provision of the Single Audit Act Amendments of 1996. Accordingly, several States believe the current manner in which single audits are conducted produce limited results. They indicate that single audit objectives and corresponding audit procedures contained in the OMB Circular A-133 Compliance Supplement do not adequately measure combined Federal/State/Local program results. As a result of these concerns, several States believe it is time to transition the focus of single audits from compliance audits to alternative engagement types (performance audits, "total program" engagements). Much time and money, however, are necessary to initiate, research, promote, and defend a pilot project proposal. Reluctance on the part of States to initiate such proposals may be thwarted by a perceived reluctance on the part of the Federal government to embrace alternative approaches. The NSAA, therefore, encourages the OMB and other Federal grantor agencies to initiate or solicit proposals for worthy pilot projects that give appropriate considerations to cost/benefit and timing issues.

Data Collection Form

The auditee is required to submit a data collection form that states whether the audit was completed in accordance with the Single Audit Act Amendments of 1996 and provides information about the auditee, its Federal programs, and results of the audit. This form provides the information that populates the Federal automated clearinghouse database. The Federal automated clearinghouse database provides multiple benefits to the single audit process. The OMB is responsible for approval of the form. With the second version of the form already in use, it is evident that OMB and other interested parties recognize the significance of the form and are committed to revising the form at appropriate intervals. It is noted that future changes to the form are also being considered.

Single Audit Quality

The creation of sound single audit legislation does not guarantee its successful implementation. We believe that overall single audit quality is dependent upon fulfillment of required responsibilities by the Federal government and by adherence to the provisions of OMB Circular A-133 by non-Federal auditors.

Federal Government Responsibilities

The Single Audit Act Amendments of 1996 included several measures of accountability. These measures were included to ensure adherence to the provisions contained within the Amendments. Notable accountability matters worthy of comment include management decisions by Federal grantor agencies, the creation and use of the Federal Clearinghouse database, and quality control reviews. Our observations regarding these three items are noted below:

Management Decisions

Federal awarding agencies and pass-through entities are responsible for issuing a management decision on audit findings within six months after receipt of the audit report and for ensuring that the recipient takes appropriate and timely corrective action. Further, the management decision is to clearly state whether or not the audit finding is sustained, the reasons for the decision, and the expected auditee action to repay disallowed costs, make financial adjustments, or take other action.

There is no doubt that Federal awarding agencies have shown improvements in the timeliness in which they address recipient audit findings since the passage of the Single Audit Act Amendments of 1996. Several states, however, continue to indicate that Federal awarding agencies are not operating at the optimum level with regards to the issuance of timely management decisions. Instances have been noted where findings continue to carry over from year to year. In applying the rules of section .315 of OMB Circular A-133, State Auditors believe these findings cannot be deleted simply because there has been a casual contact by the responsible party, such as a telephone call or email, with the recipient. Federal agencies, however, do not seem to be actively pursuing these findings and consequently, the findings do not get resolved. We have noted findings that remain unresolved for four or five years.

Creation and Use of Federal Automated Clearinghouse Database

We believe the Federal Automated Clearinghouse Database is an invaluable tool with significant applications in the single audit process. The Office of Management and Budget and the U.S. Department of Commerce (Bureau of the Census) have been proactive in their pursuit of developing a database, in conjunction with the data collection form, which provides accurate and timely information to various users. Perhaps the most significant use of this database is its capability to be used as a monitoring tool. As the database has been populated with several years of data from recipient single audit reports, we have noted that several Federal agencies are now searching the database for evidence to ensure that the appropriate Federal programs have been selected as major programs. During the past year the NSAA has partnered with the Federal government to assist with efforts in assessing the quality of single audits at the State and local level. The NSAA is supportive of future technological advances in the database that permits increased accountability on the part of auditees and non-Federal auditors.

Quality Control Reviews

NSAA considers Quality Control Reviews (QCRs) to be one of the most effective means of ensuring accountability over the quality of audits conducted by non-Federal auditors. Quality control reviews are examinations of audit work performed by non-Federal auditors to ensure that such work complies with auditing standards. Federal Office of Inspector Generals (OIGs) conduct QCRs of selected single audits. According to GAO report, dated March 2002, entitled "Single Audit – Survey of CFO Act", the OIGs of 10 CFO Act agencies performed 109 QCR's in 2001. When you consider that approximately 35,000 single audits are performed annually, 109 reviews seem low. Related to this matter, a common observation made by numerous states receiving QCRs is the lack of participation by Federal agencies other than the Federal cognizant agency for audit that arranged and coordinated the review.

A compensating measure of accountability with regard to quality control is provided by the NSAA through its External Quality Control Review Program. Participating State audit organizations are subject to a "peer review" every three years. These reviews focus on systems of quality control and compliance with established policies and procedures and applicable auditing standards. Included in these reviews are examinations of single audits, when applicable. Also, several State Auditors have statutory responsibilities that include desk reviews and/or quality control reviews over local government single audits in their respective states.

Non-Federal Auditor Responsibilities

One of the objectives of the Single Audit Act Amendments of 1996 is to "promote the efficient and effective use of audit resources". One of the primary means utilized to achieve this goal is the risk-based approach in determining major Federal financial assistance programs. NSAA's assessment of the risk-based approach and a summary of overall quality of audits being conducted are described as follows:

Risk-Based Approach in Determining Major Programs

The risk-based approach in determining major programs is accomplished through a four-step process. Included in the guidelines of the four-step process are provisions for the use of auditor judgment in the evaluation of risk criteria. Over a period of a few years, if applied correctly, the four-step process may produce a diversity in the programs audited, but may also result in fewer programs being audited each year.

During the past year much attention has been drawn to deficiencies noted in the area of major program determinations. When the appropriate programs are not determined to be major programs, the single audit process has not worked as designed. NSAA, upon hearing of the detection of deficiencies in major program determinations by the U.S. Department of Health and Human Services, partnered with the Federal government during the past year to investigate this matter. Our preliminary findings indicate that some States are reporting alarmingly high error rates in single audits of local

governments conducted by other independent auditors that are consistent with the results reported by the U.S. Department of Health and Human Services. States reporting deficiencies at the local level indicate that major programs are not being selected correctly primarily because of the auditor's failure to calculate the Type A program threshold, improper clustering of programs by the auditor, and by not selecting Type A programs which were not audited once in the preceding two audit periods. However, it must be noted that other states are reporting much higher quality work at the local government level.

Summary of Overall Quality of Single Audits

Overall, the quality of single audits conducted by State audit organizations appears to be satisfactory. This conclusion is based on the results States have received from QCR's conducted by Federal OIGs and based on NSAA's External Quality Control Review Program. Typically, a representative from the Federal government serves on the peer review team and is responsible for evaluating a State's adherence to the Single Audit Act Amendments of 1996 and OMB Circular A-133.

There is, however, a large disparity in the quality of work conducted at the local level. The most likely explanation for the variance may be linked to the degree of accountability that exists at the local level. Earlier, it was indicated that only 109 of approximately 35,000 QCRs had been conducted by Federal grantor agencies. Certainly, only a very small number of local government audits were impacted by these reviews. In addition, certain States are statutorily required to provide oversight of audits conducted on local governments in their respective States. This oversight may involve a desk review of audit reports and/or quality control reviews. Those States with responsibilities that include quality control reviews (including working papers) appear to be the same States reporting more favorable results. An assessment of the appropriateness of the review procedures used by all States conducting reviews to detect the deficiencies being reported by the U.S. Department of Health and Human Services, however, has not been made by NSAA.

Other obvious reasons for the occurrence of low quality single audits at the local level may be attributed to unqualified auditors being procured by auditees, and the lack of proper auditor training.

Section .305 of Circular A-133 addresses auditor procurement. This section indicates that consideration should be given to factors such as relevant experience, professional qualifications of staff, the results of external quality control reviews, and cost of the audit. Evaluations should be made to determine if substandard single audits result from auditees not properly adhering to this section of the Circular.

A lack of training and sufficient understanding of the Single Audit Act Amendments of 1996 and OMB Circular A-133 may explain why many auditors have failed in

NSAA Testimony
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determining appropriate major programs to audit. Auditees should also have a good understanding of the Amendments and OMB Circular A-133 to help them discern if potential independent auditors are properly qualified and possess the technical ability to conduct the audit.

In conclusion, it is difficult to know all reasons for the occurrences of low quality single audits. The NSAA recommends a system that measures the overall quality of single audits be designed and implemented by the Federal government. This system should include conducting QCRs based on random sampling from the population of completed audits in an effort to improve accountability. We realize that QCRs consume time and are costly to conduct. We, therefore, also encourage continued use of the Federal database as a means of detecting substandard audits. Thought should be given to developing alternative methodologies, which would make the auditor more accountable for their single audit work.

I would like to thank the Subcommittee for the opportunity to testify on behalf of NSAA on the Single Audit Act Amendments of 1996. I will be happy to answer any questions the Subcommittee may have.

Mr. HORN. And we now go to the Honorable Jack Martin, Chief Financial Officer for the Department of Education. Mr. Martin.

**STATEMENT OF JACK MARTIN, CHIEF FINANCIAL OFFICER,
DEPARTMENT OF EDUCATION**

Mr. MARTIN. Mr. Chairman and members of the subcommittee, good morning. It is my pleasure to be here today on behalf of the Department of Education concerning the Department's actions and progress under the Single Audit Act.

This past January, President Bush signed into law H.R. 1, the No Child Left Behind Act, closing a successful year of bipartisan cooperation in Congress and opening a new era in American education. To meet the challenges of this new law, the Secretary of Education, Rod Paige, implemented earlier this year a long-term management improvement plan, the Blueprint for Management Excellence. The blueprint sets a new direction within the Department that demands organizational excellence in programs, performance and management. The Single Audit Act complements this direction.

My role as Chief Financial Officer is to advise the Secretary on matters regarding financial management, including audit resolution. This is my first opportunity to testify since being sworn in in February. Today my remarks as the audit followup official for the Department will be directed at key audit resolution improvements and some issues that make our process unique.

Earlier this month GAO issued its draft report titled Single Audit: Actions Needed to Ensure That Findings Are Corrected. We're pleased to note from the report that the Department is doing a good job in carrying out its responsibilities under the Single Audit Act. We know, of course, there's always room for improvement.

We support GAO's recommendations that agency management should be kept apprised of single audit findings and grantee corrective actions. Our Department issues hundreds of decisions a year on single audit findings, addressing program compliance requirements. These decisions are made at the Assistant Secretary's level, and these officials or their designees are aware of and are involved in addressing compliance issues targeting their programs.

To address the findings, we will take another look at our audit resolution process to identify areas of internal control that can be further strengthened, including reviewing files to ensure proper documentation and resolution of findings.

At the Department we have long recognized the importance of single audits as a critical measure of the effectiveness of education programs and student performance at the State and local level. To get the most out of the single audit process, we adopted what we referred to as a Cooperative Audit Resolution and Oversight Initiative, or CAROI. GAO noted in their report that CAROI is a practical approach to address complex and recurring single audit findings. We also are proud of the fact that the Association of Government Accountants has designated CAROI as a best practice. Through CAROI, the Department brings all key partners, Federal and State, to the table to address audit findings.

Before CAROI the process was time-consuming, bred ill will between the Department and the grantees, and ran up high costs

through litigation, often resulting in modest monetary recoveries. With CAROI, the Department works hand in hand with the States to resolve problems identified in audit reports.

CAROI is an evolving process at the Department of Education. One of our objectives is to improve timeliness. Currently it may take a year or more to get a completed agreement among all the participant at table. We believe we can do better. Our most successful CAROI effort to date has been the Commonwealth of Pennsylvania. Over 120 findings, many involving complex issues and high dollar amounts, were resolved in a 6-month period. This extraordinary accomplishment demonstrates how State, Federal cooperation and teamwork can work when the lines of communication are fully open. The true measure of this program is its ability to address problems identified in audit reports once and for all. With this as our criteria, the Pennsylvania CAROI project was a resounding success. Subsequent single audits from the Commonwealth contain no repeat findings.

Another enhancement I'd like to mention is our Triage program. At the Department, Triage refers to the process by which we assess the seriousness of audit findings to determine the amount of attention needed for resolution. Its purpose is to promote the most efficient use of audits to assist management in achieving program goals and discharging our fiduciary responsibilities, while at the same time helping us to use our internal resources more effectively.

We're also in the process of updating our Post Audit User Guide. Our focus has been on strengthening procedures to ensure that the Department has an effective system for audit resolution, close-out, record documentation, and maintenance and followup. It is being developed as an Intranet document with links to key information. In addition to the user guide, we're also in the process of revising the Department's Discretionary Grant Handbook, which includes guidance on the value and use of single audits.

We're also continuing to improve our ability to track and monitor audit resolution efforts. This year we began an effort to build a single data base system to track, monitor and report on the postaudit status of single audits, GAO audits and ED-OIG audits. We anticipate the new combined system to be up and running earlier next year. Our current system has been designated a best practice by the Association of Government Accountants.

The Department of Education has some requirements unique in the Federal Government. One of these requirements is to establish a prima facie case for the recovery of funds when resolving our GEPA audit reports. This means that we must include a statement of the law and the facts that, unless rebutted, is sufficient to sustain the conclusion drawn in our management decision letter. In addition, our decision must include an analysis of the value of program services actually provided in determining harm to the Federal interest. This provision raises the bar for what must be included in management decisions in a way that requires the Department to take considerably more time together and analyze audit information and review it for legal sufficiency.

In closing, Mr. Chairman, our goal is to ensure that recipients correct the weaknesses identified in the single audit reports, and that we take the necessary steps to ensure the implementation of

single audit guidance as required by OMB Circular A-133. I appreciate the opportunity to come before your subcommittee and share our Department's commitment to effectively meet our single audit responsibilities. I'll be happy to answer any questions you or any member of the subcommittee may have. Thank you very much.

Mr. HORN. Thank you.

[The prepared statement of Mr. Martin follows:]

**STATEMENT BY
JACK MARTIN
CHIEF FINANCIAL OFFICER
U. S. DEPARTMENT OF EDUCATION**

**BEFORE THE
COMMITTEE ON GOVERNMENT REFORM
SUBCOMMITTEE ON GOVERNMENT EFFICIENCY,
FINANCIAL MANAGEMENT AND
INTERGOVERNMENTAL RELATIONS
STEPHEN HORN, CHAIRMAN**

JUNE 26, 2002

Mr. Chairman, and Members of the Subcommittee, it is my pleasure to be here today on behalf of the Department of Education concerning the Department's actions and progress under the Single Audit Act. My role as Chief Financial Officer (CFO) at the Department is to advise the Secretary on matters regarding financial management, including audit resolution. This is my first opportunity to testify before Congress. Since being sworn in last February, my office has made steady progress in meeting our financial management responsibilities. Today, my remarks will be directed at the overall progress we are making to improve audit resolution and a few key issues that make our process unique.

Before I do this, I would like to provide you with some perspective and background on where we are in the Department.

This past January, President Bush signed into law H.R. 1, the *No Child Left Behind* Act, closing a successful year of bipartisan cooperation in Congress and opening a new era in American education. To meet the challenges of this new law, the Secretary of Education, Rod Paige, implemented earlier this year, a new direction within the Department of Education that demands organizational excellence in programs, performance and management. This "Culture of Accountability for Results" is complemented by the Single Audit Act. The goal of both is to strengthen processes that focus on quality and outcomes.

Earlier, on October 30, 2001, Secretary Paige issued a detailed plan for transforming the Department into a high performance organization and restoring public trust in the agency. The direction marked the end of a six-month process that began with a thorough review of management issues at the Department and included an intensive effort to take action to address those issues and to develop the *Blueprint for Management Excellence*. The *Blueprint* sets goals for management improvements that will reduce possible fraud, waste and abuse of taxpayer dollars; decrease the risk of costly errors; and enable the effective monitoring of Department programs. The elements of the *Blueprint for Management Excellence* are consistent with the President's Management Agenda initiative, Improved Financial Performance. Both President Bush and Secretary Paige are serious about improving financial management and have the mutual goal of providing customers, stakeholders, and managers with timely and accurate financial information.

As CFO, I serve as the Department's Audit Follow-up Official. My responsibilities under OMB Circular A-50, Audit Follow-up, are to:

- Ensure that a system of audit follow-up, resolution, and corrective actions are documented and in place,
- Ensure the timely resolution of audit reports,
- Ensure corrective actions are actually taken, and
- Provide the Congress, on a semiannual basis, a report on the Department's audit follow-up activities.

We at the Department of Education take our audit resolution and follow-up responsibilities seriously. Single audits focus on a grantee's internal controls and compliance with laws and regulations governing federal awards. They serve as an important management tool in monitoring the administration of federally funded education programs.

Our single audit grantees include states, territories and local governments; institutions of higher learning; school districts; non-profit organizations; and loan guarantee agencies that receive direct funding from the Department of Education.

Proactive Guidance to Help Grantees Avoid Audit Findings

The Department will award approximately 4,900 new discretionary and about 7,000 formula grants this year. After awards are issued, the Department convenes all new project directors at conferences for an overview of the legislative intent and expected results on the mission of the various programs. At these conferences, project directors receive training on the administrative requirements and fiscal policy for managing their grants. The purpose of the training is to prevent high incidents of audit exceptions.

It is as important for the Department to know that a single audit has been issued with no findings as it is to know the corrective actions to be taken on audits with findings. Following is a description of the Department's process for handling single audits.

The Department's Process for Handling Single Audits and Key Improvements

Our resolution process starts once we receive a single audit from the Federal Audit Clearinghouse (Clearinghouse) within nine months after the end of a grantee's fiscal year. The Clearinghouse forwards audit reports with General Education Provisions Act (GEPA) findings to my office and audits of the financial student assistance programs to our Federal Student Aid office. The findings are sorted through a triage-type process to focus time and resources on the more significant findings. They are then distributed to appropriate program offices for resolution. These offices are responsible for assigning findings to program specialists who, in turn, obtain from auditors and auditees information needed to issue management decisions.

Throughout the resolution process, staffs within and across program and operational areas consult regularly, exchanging information in order to issue comprehensive management decisions and improve the administration of ongoing grants to recipients. In more complex cases that involve recurrent and cross-cutting findings involving, for example, several programs and large sums of questioned costs, the Department organizes groups from the Department's program, legal, financial, and audit offices for more comprehensive reviews. Those reviews result in management decisions that address systemic problems, such as through the Cooperative Audit Resolution and Oversight Initiative (CAROI), a very successful resolution mechanism that has been recognized by the Association of Government Accountants (AGA) as a "Best Practice" and is discussed in more detail below.

Earlier this month, GAO issued its draft report titled *Single Audit: Actions Needed to Ensure that Findings are Corrected*. GAO's review focused on our Department's efforts to (1) ensure that recipients take corrective actions on current year and recurring findings identified in single audits, and (2) summarize and communicate single audit results and actions to management. We were pleased to note from the report that the Department is doing a good job in carrying out its responsibilities under the Single Audit Act. We know, of course, there is room for improvement. The report will help us to make further improvements in our ability to carry out our responsibilities under the Act, and we will continue to take advantage of input from GAO, our Office of Inspector General, and our staff in making further improvements in what we do.

We agree with GAO that it is important to ensure that recipients correct the weaknesses identified in single audit reports and that the Department takes the necessary steps to ensure the implementation of single audit guidance as required under OMB Circular A-133. To this end, we are going to take another hard look at our audit resolution process to identify areas of internal control that can be strengthened, including the process of coding findings and reviewing files to ensure proper documentation and resolution of findings.

We also support GAO's recommendation that agency management should be kept apprised of single audit findings and grantee corrective actions. Here at the Department of Education, management issues hundreds of decisions a year on single audit findings that address program compliance requirements. These decisions are made at the Assistant Secretary's level, and these officials (or their designees) are aware of and involved in addressing the compliance issues affecting programs for which they are responsible. We also communicate to agency management on recurring or serious audit findings through teaming efforts and have taken management actions on numerous occasions as a result of single audit findings.

The Department has been active in streamlining what we do and working to make the process more effective. I will now discuss a few of our key improvements.

Cooperative Audit Resolution

At the Department, we have long recognized the importance of single audits as a critical measure of the effectiveness of education programs and student performance at the state and local level. To get the most out of the single audit process, we adopted what we refer to as the Cooperative Audit Resolution and Oversight Initiative (CAROI). GAO noted in its report that CAROI is a practical approach to address complex and recurring single audit findings. Through CAROI, the Department works to bring all key partners, both federal and state, to the table to address audit findings. This is unique in the Federal Government, and we have been in the forefront in taking advantage of this innovative and practical approach to audit resolution.

Before CAROI, state and local educational agencies frequently would appeal departmental decisions on audit findings to our administrative law judges.

The process was time-consuming, bred ill will between the Department and the grantees, and ran up high costs while often resulting in modest monetary recoveries. Since the inception of CAROI in 1995, there has been a substantial drop in the number of states filing appeals and a significant reduction in repeat findings for participating states.

With CAROI, the Department works hand-in-hand with the states to resolve the underlying problems identified in audit reports. We work with states where audit reports contain multiple findings that recur over several periods, or involve significant dollar amounts, or involve cross-cutting or precedent-setting issues, or a combination of the three.

CAROI is based on six key principles:

- Encourage collaboration among all participants,
- Take full advantage of opportunities for open dialogue,
- Foster a sense of trust,
- Create an open environment to identify problems and create mutual solutions,
- Encourage the resolution of audit issues by being responsive to the needs and interests of the participants, and finally,
- Encourage the sharing of solutions achieved through the process.

CAROI is an evolving process at the Department of Education. We are still working on ways to enhance it. One of our objectives is to improve the timeframe in which a CAROI project can be brought to a successful conclusion. Currently, it may take a year or more to get agreement among all the participants at the table. We believe we can do better.

One of our first successful outcomes was with the States of Florida, Mississippi, and Washington. A major result of this effort was a complete overhaul of the Elementary and Secondary Act portion of the Single Audit compliance supplement. Florida and the Department also were able to resolve the state's audit findings regarding salary allocation of time spent on one or more federal programs. But we took that a step further. Working together, we were able to develop an improved time distribution process that could be used by other state agencies and local school districts to improve the administration of their programs and preclude the occurrence of similar time distribution findings.

Our most successful CAROI effort to date has been with the Commonwealth of Pennsylvania. Over 120 findings, many involving complex issues and high dollar amounts, were resolved in a six-month period. This extraordinary accomplishment demonstrates how state/federal cooperation and teamwork can work when the lines of communication are fully open. But the true measure of this program is its ability to address and solve difficult problems identified in audit reports, once and for all. With this as our criterion, the Pennsylvania CAROI project was a resounding success. Subsequent single audits from the Commonwealth contained no repeat findings.

The Triage Process

CAROI is just one of our process enhancement programs for resolving and following-up on the audit reports of the Department. Another is our “Triage” program. At the Department, “triage” refers to the process by which we assess the seriousness of each audit finding to determine the amount of attention needed for resolution and a plan for resolving it. The purpose of “triage” is to promote the most efficient use of external audits to assist management in achieving program goals and discharging our fiduciary responsibilities, while at the same time helping us to use our internal resources more effectively. Specifically, representatives from the various offices within the Department meet on a monthly basis to discuss and reach agreement on actions to be taken to resolve each finding identified for resolution. The process helps to ensure that audit findings are handled appropriately, legally, and consistently across the Department.

Improved Guidance

We are also in the process of updating our *Post Audit User Guide*. This guide provides the Department’s policies and procedures for the resolution and follow-up of single audits, as well as for internal and GAO audits of the Department’s programs, operations and management controls. It is being developed as an Intranet document. As such, it will have direct links to information that is useful to staff involved in the post audit process. It can all be accessed and printed with just the click of a mouse. Links include relevant statutes, OMB Circulars, and the Department of Education General Administrative Regulations, as well as various forms and sample documents. We anticipate issuing the guide next month. Our focus has been on strengthening procedures to ensure that the Department has an effective

system for audit resolution, closeout, record documentation and maintenance and follow-up. We believe this updated guide will greatly facilitate our efforts to improve post audit activity at the Department of Education. Training will take place once the guide is issued.

In addition to the user guide, we are also in the process of revising the Department's *Discretionary Grant Handbook*. For the first time, under grant monitoring, detailed guidance pertaining to the value and use of single audits during the monitoring phase of a grant is included.

Enhanced Audit Tracking and Reporting

We are also continuing to improve our ability to track and monitor audit resolution efforts. Our current method for tracking single audits is through our Common Audit Resolution System (CARS). While CARS, as a whole, is a credible data dissemination tool, it was created in 1995 using the technology available at that time. And, of course, that technology is now out-of-date. This year, we began an effort to build a single database system that will track the post audit activity for all audits, external and internal. This database will be the Department's tool to track, monitor and report on the post audit status of single audits, GAO audits, and ED-OIG issued audits. This development is a continuation of our efforts to automate and streamline the Department's audit-related processes with a focus on enhancing financial integrity and strengthening management and internal controls. This new system will also replace our automated Internal Audit Corrective Action database that currently tracks our internal audits, which was designated a "Best Practice" by AGA last year. We anticipate the new combined system to be up and running early next year.

OMB Circular A-50 requires federal agencies to resolve audit findings within six months after issuing the audit for resolution. My office, on a quarterly basis, sends to other senior officers in the Department a listing of audit reports that have not been resolved within the six-month time frame. This list notifies assistant secretaries that they need to take action to resolve their overdue audits as quickly as possible. Although not perfect, this tickler system has proven useful in spurring the timely resolution of audit reports in the Department. To add to this effort, we are also taking steps to put in place an early warning system to remind managers of audits that may become overdue during a six-month period.

Requirements Unique to the Department that Affect Audit Resolution

In any discussion of our efforts to successfully resolve single audits, I believe it is important to note that the Department has requirements unique in the Federal Government.

***Prima Facie* Requirements**

We are required, under the provisions of GEPA, to establish a *prima facie* case for the recovery of funds when resolving our GEPA audit reports. This means that we must include a statement of the law and the facts with relevant evidence that, unless rebutted, is sufficient to sustain the conclusion drawn in our management decision letter. In addition, our decision must include an analysis of the value of program services actually obtained in determining harm to the federal interest. This provision raises the bar for what must be included in management decisions in a way that requires the Department to take considerably more time to gather and analyze audit information and review it for legal sufficiency.

Grantback Provisions

A provision of GEPA allows grantees that have reimbursed the Department of Education for unallowable costs to apply for up to seventy-five percent (75%) of the money for use in projects related to the initial grant(s). We usually receive only a few grantback requests a year. One fairly recent example involves the Black Hills Special Services Corporation in South Dakota, where we disallowed \$106,000 in April 2000 for various audit findings covering four fiscal years, FY 1996-99. We approved the grantee's grantback request for \$78,000. A grantback application is allowed once the grantee has corrected the deficiency and paid disallowed costs to the Department. Applications for grantbacks must be approved by program offices whose funds were initially misspent. Department-approved notices are published in the Federal Register. After comments are received and reviewed, funds are obligated and awarded to the grantee. Monitoring of programs with grantback funds continues in the usual manner.

Statute of Limitations

With certain education programs, we are barred by law from recovering funds expended more than five years prior to the period in which we seek recovery. The limitation extends to education programs covered by GEPA and applies to all but student aid programs. In addition to giving timely decisions to auditees, timely resolution ensures that the Department is not barred by statute from recovering funds that have been expended on unallowable activities. Our agency seeks to ensure this through continued oversight of timely submission of audits and resolution of findings. There are isolated situations, however, where the Statute of Limitations has proven to be a hindrance in seeking legitimate restitution. For example, there are instances in which a recipient is chronically late in submitting its single audits. Although we may have only just received an audit for resolution, the five-year Statute of Limitations begins running on the day the first expenditure was made. There have also been instances in which it is not in the best interest of the Department to resolve an audit in which litigation or an investigation is underway.

Closing

Mr. Chairman, I have briefly discussed our initiatives and actions to improve the single audit process and aspects that are unique to the Department. We believe it is important to ensure that recipients correct the weaknesses identified in single audit reports and that agencies take the necessary steps to ensure the implementation of single audit guidance as required under OMB Circular A-133. The idea is to make the most effective use of single audit results to help the Department oversee recipients and manage federal education funds. That is our goal at the Department, and I trust that my remarks today show that we are committed to effectively meeting our single audit responsibilities.

I will be happy to answer any questions you, or any Member of the Subcommittee, may have.

Thank you.

Mr. HORN. Now we have Thomas A. Carter, the Assistant Inspector General for Audit Services of the Department of Education. Mr. Carter.

STATEMENT OF THOMAS A. CARTER, ASSISTANT INSPECTOR GENERAL FOR AUDIT SERVICES, DEPARTMENT OF EDUCATION

Mr. CARTER. Good morning, Mr. Chairman and members of the subcommittee. I appreciate the opportunity to discuss how the Offices of Inspector General meet their responsibilities to assure the quality of single audits under the Single Audit Act. The IG Act mandates that the Inspector General take appropriate steps to assure that any work performed by non-Federal auditors complies with the standards for audits established by the Comptroller General. The Offices of Inspector General devote varying resources to assuring audit quality based on their resources and the needs of their agency.

OIGs apply four basic efforts to assure audit quality. Some OIGs use all four, while others use fewer. The first is performing desk reviews. All single audits undergo an initial desk review by the Federal audit clearinghouse to determine if the submitted reporting package is complete. Some OIGs or another office within their agency perform a second desk review when the report arrives at their agency.

A second effort is conducting quality control reviews, or QCRs. The OIGs conduct QCRs of the auditor's working papers on a sample basis. The objectives are to first ensure that the audit was conducted in accordance with applicable standards and meets the single audit requirements; second, to identify any followup audit work needed; and third, to identify issues that may require management attention. QCRs are performed using the PCIE's uniform quality control review guide.

The third effort for OIGs is preparing audit guidance for the auditors. The annual OMB Circular A-133 Compliance Supplement contains specific audit guidance relating to over 150 individual Federal programs. The revision of the compliance supplement usually is a collaborative effort between OMB, the program officials, legal counsel, the Chief Financial Officer's staff, and the OIG. The degree of OIG involvement in the revision process varies among agencies. At the ED-OIG we play a major role providing a compliance supplement policy official who coordinates and works with other ED officials on revisions, performs a final review, and submits the completed input to OMB.

The final quality-related effort of OIGs is to provide training and technical assistance to auditors and program officials on single audits. Again, the level of effort given to this activity varies among the OIGs. We don't have specific information on what the other IGs have done in this area, but I have included some examples of ED-OIG activities in my complete statement to illustrate the form and extent this can take.

While OIGs generally fulfill their responsibilities on single audits independently, there is a long history of coordination and collaboration among members of the PCIE on single audits. Through this coordination, we can leverage our resources and take a more unified

approach to resolving single audit issues. ED-OIG recently initiated steps to revive a committee of PCIE members' representatives that would provide a regular forum for continuing dialog on single audit matters. We met earlier this month and plan a followup meeting later this summer.

How good is the quality of single audits? We don't really have a complete answer to that question. We got a partial answer in the spring of 2001 when the PCIE audit committee conducted a survey of single audit QCRs performed over a 4-year period. The survey reported that OIGs conducted 459 QCRs, of which 75 percent were judged to be acceptable, 20 percent were technically deficient, and 5 percent were substandard. We really do not know how good the quality of the audits is because these results may not be representative of the quality of all single audits.

The selections of QCRs by us and other OIGs were based on judgmental factors rather than a random basis, and therefore the results are not projectable. To draw a statistically projectable sample of sufficient size and scope that would afford a meaningful assessment of single audit quality across the board would require the OIG community to develop and execute a sample of single audits for which all OIGs have oversight responsibilities. We have taken a first step toward achieving that projectable sample. At our June meeting the OIG community agreed to begin exploring ways to conduct a statistical sample of QCRs.

In summary, the Offices of Inspector General have a key role in ensuring the quality of single audits, and they are performing a number of efforts to improve the quality. We currently do not have a valid measure of the quality of single audits, and we cannot properly measure how effective our efforts are. This is why the current effort to develop a statistically valid sample needs to be successful.

Mr. Chairman and members of the subcommittee, I will be happy to answer any questions you may have for me.

Mr. HORN. Thank you, Mr. Carter.

[The prepared statement of Mr. Carter follows:]

**Statement of Thomas A. Carter
Assistant Inspector General for Audit Services
Office of Inspector General
U.S. Department of Education**

**Before the
Subcommittee on Government Efficiency,
Financial Management, and
Intergovernmental Relations
Committee on Government Reform
United States House of Representatives**

June 26, 2002

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to be here today to discuss how the Offices of Inspector General (OIG) meet their responsibilities to assure the quality of Single Audits performed under the Single Audit Act Amendments of 1996.

OIG RESPONSIBILITIES FOR SINGLE AUDITS

A key responsibility of the Offices of Inspector General is to assure the quality of Single Audits, and other audits performed by non-Federal auditors. This responsibility is specifically mandated in the Inspector General Act of 1978 (IG Act).

The IG Act mandates that all Federal Inspectors General "take appropriate steps to assure that any work performed by non-Federal Auditors complies with the standards [for audits] established by the Comptroller General."¹

Over 34,000 Single Audits are filed with the Single Audit Clearinghouse each year by state and local agencies and non-profit organizations receiving Federal funds. Single Audits report on accounting of Federal funds, applicable internal controls, and compliance with Federal laws and regulations by these entities, and they are critical tools for oversight of entities receiving more than \$300,000 in funds from the Federal Government.

Under the regulations implementing the Single Audit, Federal award recipients expending \$25 million or more annually are assigned a cognizant agency for

¹ Section 4(b)(1)(c), Inspector General Act of 1978, as amended.

Audit. The cognizant agency provides technical assistance to the award recipients and their auditors in implementing the Single Audit Act. The Office of Management and Budget (OMB) recently made new cognizant agency assignments, resulting in more than 1,000 such assignments. The Department of Education (ED) has 303 assignments, which is the most for any Federal agency.

The Offices of Inspector General devote varying resources to the cognizant agency functions based on the needs of their agency. The resources range from 1 full-time equivalent staff to 14. ED OIG has devoted about ten percent of its resources to Single Audits, as well as other Non-Federal Audits of ED program participants. Specifically, we have a Non-Federal audit team of seven professionals. In addition, staff at our regional offices performs quality control reviews of Non-Federal Audits.

There are four basic efforts to assure audit quality. These efforts are: (1) Desk Reviews, (2) Quality Control Review (QCR), (3) Audit Guidance, and (4) Training and Technical Assistance to Auditors and Program Officials. Some OIGs use all four, while others use fewer.

Desk Reviews

All Single Audits undergo an initial desk review to determine if the reporting package is complete² when submitted to the Federal Audit Clearinghouse in Jeffersonville, Indiana, operated by the Bureau of the Census, Department of Commerce. Some OIGs or another office within the agency perform a second desk review when the report arrives at the agency. For example, in ED, two different offices review ED's Single Audits. The Office of Federal Student Aid (FSA) receives and reviews all Single Audits for entities receiving FSA funds before initiating audit resolution. ED's Office of the Chief Financial Officer reviews all other Single Audits containing audit findings requiring corrective action and coordinates with program officials to accomplish audit resolution.

The President's Council on Integrity and Efficiency (PCIE) has issued a desk review guide and checklist, entitled *Uniform Guide for Initial Review of A-133 Audit Reports* for use by OIGs.

Quality Control Reviews

The objectives of a QCR of a Single Audit are to: (1) ensure that the audit was conducted in accordance with applicable standards and meets the Single Audit requirements; (2) identify any follow-up audit work needed; and (3) identify issues

² OMB Circular A-133, Paragraph 320(c) states that the Reporting Package shall include: (1) Financial statements and schedule of expenditures of Federal Awards; (2) Summary schedule of prior audit findings; (3) Required auditors reports; and (4) Corrective Action Plan.

that may require management attention. QCRs are performed using the *Uniform Quality Control Review Guide*, published by the PCIE in 1999.

Audit Guidance

The third effort of major significance for OIGs is preparing audit guidance for the auditors. The annual *OMB Circular A-133 Compliance Supplement* contains specific audit guidance relating to over 150 individual Federal programs. It identifies the important compliance requirements that the Federal government expects to be considered as part of an audit. The *Compliance Supplement* provides a source of information for auditors to understand Federal program objectives, procedures, and compliance requirements, as well as audit objectives and suggested audit procedures for determining compliance with these requirements.

The revision of the *Compliance Supplement* usually is a collaborative effort between program officials, legal counsel, the Chief Financial Officer's staff and OIG. The degree of OIG involvement in the revision process varies among agencies. In ED OIG, we play a major role, providing a *Compliance Supplement Policy Official*, who coordinates and works with other ED officials on revisions, performing a final review, and submitting the completed input to OMB.

Training and Technical Assistance

The other effort of significant emphasis of OIGs is to provide training and technical assistance to auditors and program officials on Single Audits. We do not have specific information on what other OIGs have done in this area, but ED OIG activities may illustrate the form and extent it can take.

We conduct training and participate in national conferences. Some of our past and planned efforts in this area include the following:

- We conducted a series of two-day training sessions at 11 locations for auditors performing Single Audits (or other required audits) of colleges, universities, and postsecondary institutions.
- We provided comprehensive Single Audit Overview training to ED Program Officials, including ED Regional Offices.
- We conducted specific training for ED program officials and attorneys involved in drafting revisions to the *OMB Circular A-133 Compliance Supplement*.
- We have given speeches on Single Audit topics at national meetings of state and local officials, including the National Title I Conference and Vocational Rehabilitation Financial Management Conference.

- In July 2002, the Director of our Non-Federal Audit Team will participate as a panelist in an all day continuing professional education program for certified public accountants (CPAs) that will be broadcasted on closed circuit television at 50 sites in 20 states.

We also provide technical assistance to auditors, and ED, state, and local program officials upon request by telephone, as well as on our Non-Federal Audit Website.

INTERACTIONS WITH PCIE

While OIGs generally fulfill their responsibilities concerning Single Audits and other non-Federal audits independently, there is a long history of coordination and collaboration between members of the PCIE and OMB on Single Audits.

In the early 1980s, when Single Audits were established by executive direction (under the former OMB Circular A-102), PCIE members coordinated with each other regarding Single Audit matters. Early PCIE collaborative efforts included the publication of *Cognizant Agency for Audit Guidelines* (commonly known as the "Orange Book") and regular meetings of PCIE member representatives who led their offices' Single Audit oversight activities. In 1999, the PCIE issued the checklists for quality reviews of Single Audits that we and other PCIE members use today.

Some noteworthy interactions that ED OIG has had with PCIE members included:

- We actively participated on a committee that drafted a revision of the "Orange Book." When approved and issued by the PCIE, the revision will describe the procedures and approaches agreed upon by the PCIE on implementing the Cognizant Audit Agency responsibilities of the Single Audit Act Amendments of 1996.
- We have worked closely with other PCIE members in performing QCRs of state government entities and in participating as members of multi-agency teams, performing QCRs of audits of state government entities.
- We participated with other PCIE members' representatives and OMB, in a Single Audit Roundtable, convened early this year by the American Institute of Certified Public Accountants (AICPA).

ED OIG recently initiated steps to revive a committee of PCIE members' representatives that would provide a regular forum for continuing dialogue on Single Audit matters of mutual interest and government-wide concern. An initial

meeting was held on June 6, 2002, with a follow up meeting to be held later this summer. We are very optimistic that these meetings will result in a proposal for approval from the full PCIE to formally establish this committee and have it report to the PCIE's Audit Committee.

AUDIT QUALITY

Single Audits and other non-Federal audits are important tools that the Departments and agencies can rely upon to ensure that entities receiving Federal funds properly account for and use those funds and have adequate systems of internal controls.

How good is the quality of these audits? A partial answer was provided in Spring 2001 when the PCIE Audit Committee conducted a survey of Single Audit QCRs performed by OIGs. The survey results were 459 QCRs conducted, of which 344 (75%) were judged to be acceptable; 92 (20%) were technically deficient; and 23 (5%) were substandard.

When work is judged to be *technically deficient*, the problems are of such a nature that they must be fixed, prior to the audit being acceptable. In such cases, we require the auditor to take corrective action for the audit being reviewed. *Substandard* work involves problems of such severity, that the audit as a whole is unacceptable. In those instances, the entire audit, or substantial portions, must be redone.

The kinds of issues that render an audit to be technically deficient include instances such as:

- Not obtaining required written representations or assertions from management;
- Not including or including an incomplete Schedule of Findings and Questioned Costs; and
- Not performing some required tests.

If problems such as these are pervasive, especially when a significant number of required tests are not performed, the audit is judged to be substandard.

We require corrective action for reports that are *technically deficient* and *substandard*. For audits that are substandard, we generally refer auditors who are CPAs to state licensing officials and, if they are members, to the AICPA for disciplinary action.

We cannot say if the results of the PCIE'S survey answer the question about Single Audit quality because the results may not be representative of the quality of Single Audits as a whole. Specifically, the selections of QCRs by us and other OIGs are based on judgmental factors rather than on a statistical sample. To draw a statistically projectable sample of sufficient size and scope, that would afford a meaningful assessment of Single Audit quality across-the-board, would require the OIG community to collaborate, develop and execute a sample of Single Audits for which all OIGs have oversight responsibilities.

We have taken the first step towards achieving a projectable sample. At the June 6, 2002, meeting of PCIE members' representatives, they agreed to convene a work group later this summer to explore the practicality of conducting a statistical sample of QCRs of all Single Audits. The plan is to attempt to develop an approach for performing QCRs to be performed by participating OIG PCIE members. If developed, it will be presented to the PCIE for approval. I believe the results would provide statistically reliable answers to questions concerning Single Audit quality.

In summary, the Offices of Inspector General have a key role in assuring the quality of Single Audits and other audits performed by non-Federal auditors. The OIGs accomplish this by performing desk reviews, conducting quality control reviews, preparing audit guidance, and providing training and technical assistance to auditors and program officials on Single Audits. There is also a long history of coordination and collaboration between members of the PCIE on Single Audits, as is evident by the June 6, 2002, meeting which provided a forum for discussing Single Audit matters of mutual interest and government-wide concern. Ultimately though, we do not have a valid measure of the quality of the Single Audits and we cannot properly measure how effective our efforts are. Therefore, it is important that the activity now underway to develop a statistically valid sample is successful.

Mr. Chairman and Members of the Subcommittee, I will be happy to answer any questions you may have.

Mr. HORN. And our last presenter is Elizabeth Hanson, Director of the Departmental Real Estate Assessment Center of the Department of Housing and Urban Development.

STATEMENT OF ELIZABETH A. HANSON, DIRECTOR, DEPARTMENTAL REAL ESTATE ASSESSMENT CENTER, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Ms. HANSON. Thank you, Mr. Chairman and members of the subcommittee.

Financial and compliance audits, including audits of State and local governments and nonprofit entities under the Single Audit Act, are an essential element of the U.S. Department of Housing and Urban Development's management control and oversight of its housing and community development programs.

The Office of Public and Indian Housing's Real Estate Assessment Center is responsible for electronically collecting and assessing audit reports from housing providers receiving financial assistance from either the Office of Public and Indian Housing or the Office of Multifamily Housing. For the approximately 3,200 public housing agencies and the 8,700 nonprofit owners of multifamily projects, this means an audit in accordance with the Single Audit Act and OMB Circular No. A-133. The Real Estate Assessment Center uses the financial submissions to assess the financial condition and regulatory compliance of the property, or the PHA, and assigns the property or PHA to one of three risk categories depending upon whether the property is a good, marginal or troubled performer.

The financial submissions and assessment results are referred to program staff in HUD's Office of Public and Indian Housing and the Office of Multifamily Housing for use in risk-based targeting of technical assistance, onsite monitoring and enforcement activities to improve program compliance and performance.

The Real Estate Assessment Center has set up a division to assure the quality of the audits. The Quality Assurance Subsystem consists of a staff of auditors whose primary purpose is to conduct quality assurance reviews, together with certified public accounting firms that perform financial statement audits of HUD housing program participants.

Based on several factors, we select high-risk firms for quality assurance reviews annually. The selection criteria includes outstanding referrals from both financial analysts at the Real Estate Assessment Center and HUD program offices, total assets audited by the firm among all HUD-related engagements, and total revenues audited by the firm for HUD-related engagements. Also, if a firm audited 10 or more entities during the previous fiscal year or identified no audit findings, that is considered a factor for selection.

When substandard work is identified, the QASS team recommends administrative sanctions which include one or more of the following: Referral to one or more of the State boards of accountancy in the States where the CPA firm practices, referral to HUD's Departmental Enforcement Center for potential debarment proceedings, and referral to the American Institute of Certified Professional Accountants.

There are approximately 340 CPA firms auditing about 2,150 PHAs, and the top 10 percent of those firms audit about 68 percent of this population. Many of these firms are either sole practitioners or firms with three or fewer CPAs on staff. The average number of audits performed by the top 10 percent of firms is 44 audits per year, with a range between 35 and 114 audits. Seven sole practitioners do more than 50 audits annually, with one CPA doing 98 audits by himself. A firm with only 3 CPAs audited 8 of the 33 largest PHAs in the country.

Analysis of referrals that QASS has received, as well as the quality assurance reviews already completed indicate that several high-volume practitioners do not have the resources to perform PHA audit engagements in accordance with the professional auditing standards or within timeframes required by the Department. A combination of high volume and limited staff resources means that audit quality suffers. With fees being directly related to the time spent on an audit engagement, fewer staff hours not only result in a lower fee, but also a lower quality of work.

Of the 25 PHA auditors reviewed during the 12 months ending February 2002, QAR results indicate that 20 firms were not in compliance with professional auditing standards. We have made 18 referrals for administrative sanctions, and we have an additional 10 referrals pending. The majority of these are to the State boards of accountancy where the CPAs practice. However, there are four debarment actions pending at the Departmental Enforcement Center.

For multifamily housing projects, regardless of whether it is a profit-motivated owner or a nonprofit, we've determined that there are approximately 2,260 CPA firms providing audit services to the populations of owners required to submit audits to HUD. For this program, the top 10 percent of firms audit about 55 percent of the population.

In fiscal year 2001, we reviewed 87 firms that performed multifamily audits, both A-133 and program-type audits, though primarily profit-motivated owners. QASS identified only one firm with severe performance problems. In general the firms that perform the most multifamily audits are regional, large local or national firms with adequate staffing for their workload.

Other HUD grant programs such as those administered by the Office of Community Planning and Development are also relying on audits under the Single Audit Act as an essential component of their program management control and oversight. In this area, HUD's program field staff are responsible for obtaining and acting on single audits to ascertain the financial condition and compliance of the program participants. However, recent review by the U.S. General Accounting Office cited that these HUD program areas do not have a central system to assure that single audits are properly received and acted upon. HUD has plans in place to better assure that all required single audits are properly received and acted upon in all HUD program areas.

Thank you.

Mr. HORN. We thank you.

[The prepared statement of Ms. Hanson follows:]

STATEMENT OF ELIZABETH HANSON
Director, Real Estate Assessment Center
U.S. Department of Housing and Urban Development



BEFORE THE
UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON GOVERNMENT REFORM
SUBCOMMITTEE ON GOVERNMENT EFFICIENCY, FINANCIAL
MANAGEMENT, AND INTERGOVERNMENTAL RELATIONS

June 26, 2002

Thank you for the opportunity to appear before you today.

Financial and compliance audits - including audits of State and local governments and non-profit entities under the Single Audit Act - are an essential element of the U.S. Department of Housing and Urban Development's (HUD) management control and oversight of its housing and community development programs.

The Office of Public and Indian Housing's Real Estate Assessment Center is responsible for collecting and assessing audit reports from housing providers receiving financial assistance from either the Office of Public and Indian Housing or the Office of Multifamily Housing. Thus, each of the approximately 3,200 Public Housing Authorities (PHAs) and each owner of about 21,000 insured/assisted multifamily properties is required to electronically submit an annual financial statement audit to the Real Estate Assessment Center for a financial and regulatory compliance assessment.

For the approximately 3,200 PHAs and the 8,700 nonprofit owners of multifamily projects this means an audit in accordance with the Single Audit Act and OMB Circular No. A-133. The Real Estate Assessment Center uses the financial submissions to assess the financial condition and regulatory compliance of the property or the PHA, and assigns the property or PHA to one of three risk categories, depending on whether the property is a good, marginal or troubled performer. The financial submissions and assessment results are referred to program staff in HUD's Office of Public and Indian Housing and Office of Multifamily Housing for use in risk-based targeting of technical assistance, on-site monitoring and enforcement activity to improve program compliance and performance.

To determine if the financial audit information being assessed is reliable, the Real Estate Assessment Center has set up a division to assure the quality of the audits.

The Quality Assurance Subsystem (QASS) consists of a staff of auditors, whose primary purpose is to conduct Quality Assurance Reviews (QAR) of Certified Public Accounting firms that perform financial statement audits of HUD housing program participants. The staff is supported by the QASS system, software used to monitor the performance of CPA firms that conduct audits of HUD program participants.

Based on several factors, the QASS team selects "high risk" firms for quality assurance reviews annually. The QAR selection criteria includes outstanding referrals from both financial analysts at the Real Estate Assessment Center and HUD program offices, total assets audited by the firm among all HUD related engagements, and total revenues audited by the firm for HUD related engagements. Also, if a firm audited ten or more entities during the previous fiscal year, but identified no audit findings, that is considered a factor for selection.

A team of QASS auditors visits selected firms' offices and reviews a sample of audits and the associated working papers for compliance with professional auditing standards and HUD requirements.

When substandard work is identified, the QASS team recommends administrative sanctions which could include one or more of the following: Referral to one or more of the state boards of accountancy in the states where the CPA firm practices; referral to HUD's Departmental Enforcement Center for potential debarment proceedings; and referral to the American Institute of Certified Accountants.

QASS has determined that for PHAs, there are approximately 340 CPA firms auditing about 2,150 PHAs and that the top ten percent of the firms audit about 68 percent of the population. Many of these firms are either sole practitioners or firms with three or fewer CPAs on staff. The average number of audits performed by the top ten percent of firms is 44 audits per year, with a range between 35 and 114 audits. Seven sole practitioners do more than 50 audits annually, with one CPA doing 98 audits by himself. A firm with only three CPAs audited 8 of the 33 largest PHAs in the country.

Analyses of referrals that QASS has received, as well as QARs already completed, indicate that several high volume practitioners do not have the resources to perform PHA audit engagements in accordance with professional auditing standards or within timeframes required by the Department. The combination of high volume and limited staff resources means that audit quality suffers. With fees being directly related to the time spent on an audit engagement, fewer staff hours not only results in a lower fee but also a lower quality of work.

Of the 25 PHA auditors reviewed during the 12 months ended February 2002, QAR results indicate that 20 firms were not in compliance with professional auditing standards. Among those 20 firms, it was not uncommon for firms to violate seven, eight, or nine of the ten professional auditing standards. QASS has made 18 referrals for administrative sanctions and has an additional ten referrals pending. The majority of these are to the state boards of accountancy where the CPAs practice, however there are four debarment actions pending at the Departmental Enforcement Center.

For Multifamily housing projects, regardless of whether it is a nonprofit or profit motivated owner, QASS has determined that there are approximately 2,260 CPA firms providing audit services to the population of owners required to submit audits to HUD. For this program, the top ten percent of firms audit about 55 percent of the population. In FY 2001, QASS reviewed 87 firms that performed multifamily audits; both A-133 and program type audits, though primarily profit motivated owners. QASS identified only one firm with severe performance problems. In general, the firms that perform the most multifamily audits are regional, large local or national firms with adequate staffing for their workload.

Based on the work of the Real Estate Assessment Center Quality Assurance staff, the quality of A-133 audits of Housing Authorities is of concern, while the audits of Multifamily housing projects are generally of a higher quality.

HUD is concerned about the quality of Single Audits and has dedicated staff resources to the quality review process for the past three years. The Department supports the concept

of a task force to review the quality of Single Audits and is ready to lend what we have learned from our experience to the task force.

Other HUD grant programs, such as those administered by the Office of Community Planning and Development, are also reliant on audits under the Single Audit Act as an essential component of their program management control and oversight. In these areas, HUD's program field staff are responsible for obtaining and acting on Single Audits to ascertain the financial condition and compliance of their program participants. However, a recent review by the U.S. General Accounting Office cited that these HUD program areas do not have a central system to better assure that Single Audits are properly received and acted upon. HUD has plans in place to better assure that all required Single Audits are properly received and acted upon in all HUD program areas.

Thank you for the opportunity to appear today.

Mr. HORN. And now we'll start the Q and A, and one question I want to all of you to answer, and that has been mentioned, the Office of Management and Budget is working toward increasing the single audit threshold from \$300,000 to \$500,000.

Ms. HANSON, what are your views on the increase?

Ms. HANSON. We have looked at it from the perspective of the multifamily and public housing programs, and it's not going to significantly impact our oversight of those public housing agencies or the multifamily property owners. In terms of the dollar amounts covered by those entities, it's not significant. And in addition, we continue to receive the unaudited financial submissions from those property owners and public housing agencies, so we still have the ability to look at the financial information.

Mr. HORN. Mr. Carter.

Mr. CARTER. We haven't taken an official look at it yet, but from discussions with my non-Federal staff, I believe our position would be that it would not be a bad idea to increase the threshold.

Mr. HORN. Mr. Martin.

Mr. MARTIN. We haven't officially examined the \$500,000 threshold, but I think our position would be to support it.

Mr. HORN. Mr. Hinton.

Mr. HINTON. The National State Auditors Association would support such a proposal. As I stated in my testimony, some of the concerns are among the States for—whereby the State has linked their monitoring efforts to the threshold, and there will have to be some review there, but NSAA would be in support of it.

Mr. HORN. Mr. Knickerbocker.

Mr. KNICKERBOCKER. Increasing the threshold will presumably reduce the number of submissions, but from the clearinghouse standpoint, we stand ready to process any number of submissions.

Mr. HORN. Mr. Knickerbocker.

Mr. KNICKERBOCKER. Oh, yes, sir. Again, as I said, presumably increasing the threshold will reduce the number of submissions, but from the clearinghouse standpoint, we stand ready to process any number of submissions.

Mr. HORN. Mr. Everson.

Mr. EVERSON. I'd just point out here, our understanding is there are about 34,000 entities that get audited. This would knock out 6,000 of those entities. That's only 18 percent, but it would—the dollar coverage would be less than 1 percent that you're losing by taking that step. So we think it lightens the burden, reduces the burden on the public with no change in the risk quotient from the overall Federal Government point of view.

Mr. HORN. Ms. Thompson.

Ms. THOMPSON. On the surface I think GAO would be in support of that, but I would say that there needs to be a balancing to look at the subrecipients, because the Federal agencies are not getting those reports from the subrecipients. They are going directly to the State, and we don't know what the effect would be on those, and I think there needs to be an analysis on that.

Mr. HORN. I thank you. We're going to be in recess until 11 a.m., and Mr. Miller will assume the Chair as chairman. And so I thank you very much for coming.

Mrs. MALONEY. May I ask one question?

Mr. HORN. Well, can you wait for Mr. Miller, because I have to be in Transportation. Otherwise I'd love to do it.

[Recess.]

Mr. MILLER [presiding]. The hearing will continue. We will proceed with questions and ask Mrs. Maloney to go.

Mrs. MALONEY. I am delighted to join with my good friend Dan Miller and place my regrets that he has decided not to run for reelection. He has been an outstanding Member of this body and I will miss him. I wish he would reconsider.

I also welcome all the witnesses and just briefly state that the Single Audit Act was created in 1984, amended in 1996, in order to ensure that money awarded by the Federal Government is well spent by the private organizations that get it. Entities that receive over \$300,000 of the taxpayers' money must arrange to have a single audit which agencies, with the help of the Federal Audit Clearinghouse, are supposed to review in order to spot misuse of government funds.

Many agencies also consult the audits before awarding money, to check how recipients have handled previous awards of Federal money. Those agencies who do not should begin this commonsense practice.

As someone who has tried to serve and work with Mr. Miller and others to look at ways to better manage taxpayers' money, I am disturbed by some of the failings that have been reported by the single audit system. For example, the Department of Health and Human Services—and I understand they are not with us today—has twice been cited in GAO reports as not having any comprehensive way to deal with the Single Audit Reports that come into its agencies. In an April 23rd report and a June 11th report that I requested, with Wisconsin Representatives Barrett and Kleczka, the GAO reported that HHS did not know the extent to which the single audits they had received revealed the misuse of funds because they had no comprehensive system of analyzing the reports.

The Department of Health and Human Services serves the neediest among us. It is our job to make sure that money intended to provide food, schooling, or job training is not wasted or stolen by incompetent or criminal organizations. And without adequate oversight from HHS, we have no way to tell how much of that money is truly going to the ones that most need our help.

I know we have other Federal agencies represented here today, and I look forward to reading your testimonies. I did hear some of it.

But as I was talking while we were waiting with Mark Everson from the OMB, the Comptroller there, he indicated, I thought, something very wise to me: that this really has to be a team effort with the States and the localities, and that we send this money oftentimes in block grants or direct grants to the States and localities, and that they should be playing their part in making sure that these funds are well spent.

I used to be a member of the City Council of New York for 10 years, and have many friends on that body. And if any of you have any ideas of how we could—I'll just use my city, because I know New York has many needy people and has many—a great deal of funding from HHS and other housing and other areas—of ways

that we could get the city to work with us to help us improve what we're doing.

I can tell you, when I did come to the Federal Government from the city of New York, I was amazed at how well run the Federal Government is. I think it is extremely well run compared to the city of New York, which I think is well run, but your controls and oversight were superior to that which we had worked to put in place in the city.

[The prepared statement of Hon. Carolyn B. Maloney follows:]

Statement of Representative Carolyn B. Maloney

to the Subcommittee on Government Efficiency,
Financial Management and Intergovernmental Relations

Hearing: “ The Single Audit Act: Is it Working?”

Mr. Chairman and Ms. Schakowsky, thank you for holding this hearing.

Welcome to all the witnesses who will testify today. The Single Audit Act was created in 1984 and amended in 1996, in order to insure that money awarded by the federal government to private organizations is well spent. Entities who receive over \$300,000 of the taxpayers money must arrange to have a single audit, which agencies, with the help of the Federal Audit Clearinghouse, are supposed to review in order to spot misuse of government funds. Many agencies also consult the audits before awarding money to check how recipients have handled previous awards of federal money. Those agencies who do not, should begin this common sense practice.

As someone who has tried to serve as a watchdog for the American people on these issues for many years, I find it extremely disturbing that some agencies have failed to use the single audit system properly.

For example, the Department of Health and Human Services has twice been cited in GAO reports as not having any comprehensive way to deal with the single audit reports that come in to its agency. First in an April 23rd report, and again in the June 11th report that I requested with Wisconsin Representatives Barrett and Kleczka, the GAO reported that HHS did not know the extent to which the single audits they had received revealed a misuse of funds, because they had no comprehensive system of analyzing the reports.

The Department of Health and Human Services serves the neediest among us. It is our job to make sure that money intended to provide food, schooling, or job training, is not wasted or stolen by incompetent or criminal organizations. Without adequate oversight from HHS, we have no way to tell how much of that money is truly going to help those who most need our help.

I know we have other federal agencies represented here today. I look forward to hearing from each of you as to how we can work together to best serve the taxpayers and direct their money to where it is supposed to go.

Thank you.

Mrs. MALONEY. I have two questions:

No. 1: How can we get the localities to take some of this burden off of us, and responsibility, to make sure that the moneys are spent well?

And the second is really the result of the GAO report that said that often they will, in the single audit, they will analyze and see something wrong; yet then there is no followup to make sure that it is corrected. So why even bother to have an audit if you are not going to then take the next step, which is to correct whatever it is that is a mismanagement, which may be just something as innocent as not really being a sophisticated manager in some areas of the country or even in the city of New York? Why bother with a single audit if we don't correct the problems that come out of it?

I would like to open those two questions up. If anyone has an idea of how you respond to the point that I raised that oftentimes they come up with ideas that are of mismanagement, yet no one follows through, how do we get the Federal Government to follow through? But, on the other hand, it should not just be the Federal Government's responsibility, it should be part of the city's and the State's to work in partnership with us. How do we shift some of this responsibility in a way that is accountable to the local areas so that we can make sure that the dollars get to the people who need it, and, very importantly, are well spent in the way that we intend when we vote in Congress to help the poor that it truly does?

So I just open it up for comments from anybody.

Thank you, Mr. Chairman for yielding to me. Always a gracious gentleman. Thank you.

Mr. EVERSON. Maybe I could try to frame it from the center at OMB, if you will, and from the President's Management Council point of view, if I could.

First, thank you very much for your offer on New York City, and we will take a look at that and come back to you.

But the President's management agenda has, as one of his five core areas, improved financial performance. Central to that is the reduction of erroneous payments. This is part and parcel of that effort, because what you have here is you have an attack on this through two levels. One is very much through the departments that run these programs, and the word "accountability" that was used earlier is quite—quite central to this—this whole issue.

We are working with the departments, including those represented here and others, to make sure they're following up on this whole area. They're doing studies and indicating to us what the erroneous payment rate is, which is—which is clearly one of the things you determine through these audits. And I think we are going to make some progress.

It is a complicated issue, though, and it is complicated because of the other point that you raised, which is that they don't directly control these moneys. The moneys are given to others who then run these programs. And frequently, I have to be honest here, the imposition of controls is resisted, even within this body, because there'll be pushback from States or from counties as to the imposition, say, of penalties. An example of that being just now in the farm bill and changes we wanted to make in food stamp areas, just

the penalty phase; if people spent too much money and did not have the adequate controls, there's oftentimes a lot of pushback, because if you're going to get a penalty, obviously it costs the State money.

It is a very complicated dynamic, and you need to work at both the department level but also at the State level, and we need your help there because sometimes they don't want to cooperate.

Mrs. MALONEY. If I could followup on your comments, that one way to address that is to come forward with how we want these controls federally. And instead of imposing the penalty, say if you want this money within a 5-year period or a 10-year period, you implement this type of management control. You know, I think sometimes, particularly in serving the poor when the need is so much, they are just overwhelmed; people are overwhelmed, and they can't really spend the time to think of how they could better control it.

So maybe we in the Federal Government that has more experience in controls and oversight could come up with some ideas that we could just suggest, maybe instead of a penalty, we could put out an incentive; say you correct this in X, Y, Z ways, and then we will give you more money.

Now, very briefly, on the State and city of New York, by far the Federal budget goes to the city of New York, not the State, because the city of New York serves the—it's where the poor live. And it's the urban center of where the population really lives. And I was always surprised on the State to see how much more money was really in the city on contracts, building, Medicaid, Medicare, Social Security than upstate. You always think the State is bigger. But as I said, if you wanted some model cases or some hearings or some, you know, just some thought on how you could do this, I could certainly work with you with the city of New York. All 52 members are still friends of mine because I served with them.

Mr. EVERSON. I would like to do that.

Mrs. MALONEY. Maybe that would be a better way of getting that done, as opposed to saying we are going to give you a penalty, when most cities and States have a huge budget gap. The city of New York has a \$5 to \$6 billion budget gap. If you talk about a penalty, they are going to be upset because they need the money. But if it came in in the beginning, not in an onerous way, but we will give you 5 years to correct your erroneous payment problem by X, Y, Z, they would welcome the leadership of how to respond, because no one wants their limited dollars being spent inappropriately.

Thank you.

Mr. MARTIN. I believe that many cities continue to fund some recipients that are financial basket cases. And I believe that if they improve followup of these subrecipients, and consider the audit findings in future awards, that would reduce the findings considered in the single audit process.

Ms. THOMPSON. I'm from GAO, Mr. Congressman; nice to have you here; nice to be here today. One of the things that I mentioned in my remarks before you came in was that I felt there was a real need for the States to report on the subrecipients, because the Federal agencies are not getting the information on the audit findings

of these subrecipients. I'm a firm believer that by reporting, you increase accountability. But more than that, you could do analysis. The Federal agencies then can look across the subrecipients and see where the problems are.

For instance, we've seen a lot of audit findings in eligibility, and you take that down to an individual program then, and if you see that prevalent across many States, you need to then look at what is the reason that they're finding audit problems in eligibility? It allows that kind of analysis. Right now, the States are not reporting up on who the subrecipients are, nor are they reporting up on what kind of audit findings are being identified out there by the audits and what kind of followup actions are being taken to correct those problems. Even though those audits are in the clearinghouse data base, that information is not going out to the Federal agencies.

And I think if we had, again as you mentioned, a partnership among everybody within the State up to the State level, and then the States with the agency level, we could increase our accountability but, more importantly, give them the information they need to do this kind of analysis.

Mrs. MALONEY. Thank you.

Mr. MILLER. Thank you. Let me ask some questions of Mr. Everson, and I know he has to leave early. Three questions I will ask you, and then you can cover them all at one time.

The GAO report issued today raises questions about the adequacy of agency efforts to ensure that recipients of Federal awards are correcting weaknesses identified in the single audit reports. What is the OMB's role in ensuring that the weaknesses are corrected?

A recent GAO survey indicated that agency quality control reviews have found problems with the quality of some single audits. The question is, how pervasive is this problem?

The third question is, what is OMB doing to ensure that all required single audits are being performed?

Mr. EVERSON. Taking the first one, as I indicated before, the President has articulated improving financial management as one of the five governmentwide efforts that we are undertaking as part of the President's management agenda. This is a very central element of it, reducing erroneous payments, so we take very seriously the work that GAO has done here in looking at the efforts, really, of the departments which control the largest pieces of this \$300-some-odd billion of grants that are out there.

We have concerted efforts, working with the departments, to increase our monitoring of what they're doing in this area, and as you may know, we are evaluating their progress quarterly. In fact, we will be updating our management—executive branch management scorecard on where each agency stands, their efforts in this area; and, for instance, be giving my colleague here, Jack, a grade on how the Education Department is doing on improving financial management.

That will be published and be available to everybody on July 15th when we do the midsession reviews. So there is a great deal of accountability and a great deal of focus on this whole effort. And it will take into account things like GAO reports on this area. So

that's the first question. I think it is receiving the attention it needs and will be highlighted.

The quality of the audits. I think that as several people touched on, I don't think we really know as well as we should just whether the audits themselves are of the standard across the board that we would want, the points that were made about the involvement of the inspectors general and also, I would think, the CFOs that get a clear view of this, they're central. We need to do more in terms of the sampling of the audits, more peer reviews.

I think the PCIE, which is the group of IGs and the audit committee that was referenced, they're working on this. We are working on this with them. But I think we do need to do more. And as I indicated before, this is a tough time to be in the audit business. They're in for a lot of criticism in the work that's being done in the private sector. We need to make sure that we have very high standards here. So I think more needs to be done and we will do that.

I am the acting chair of the PCIE, and I will make sure that I reiterate that as we work on that on the IG side.

Help me again on the third question?

Mr. MILLER. What are you doing to ensure that all required single audits are being performed?

Mr. EVERSON. I think that is, again, an active area of collaboration amongst the bodies that we have in place. And there is a grants subcommittee that works within the CFO Council structure and works directly—we have a lot of coordination on this—with GAO and with the departments through the CFO Council. But I think that, as was mentioned earlier, that—I think you used the word “honor system.” I don't think we have quite figured out a fool-proof way here to make sure that everybody who should provide an audit is so doing. That remains to be seen how we would make that air-tight.

Again, though, I think that we are picking up, we are sweeping in the big-dollar items, as I indicated before. The exposure here may be on some of the smaller grantees, is where I think there is probably greater risk.

Mr. MILLER. Let me ask about the Federal Financial Management Improvement Act. Could you comment on the OMB's views of the effectiveness of the Federal Financial Management Improvement Act and what action is being taken to address the continuing poor condition of the financial systems across the government?

Mr. EVERSON. I think that the act has been very important in trying to direct agencies to get to systems that are compliant with Federal standards, both as to their own individual needs, but moreover to get to a common set of transaction processes and standards such that you could actually use this information on a central basis.

As you know, right now we don't have audited financial statements for the U.S. Government. GAO can't opine on the financial statements of the U.S. Government. Part of this is systems driven; that we can't even collect and provide information, adequate information on all the intergovernmental transactions. You can't get there until you have good systems that produce the right information in the right account structure.

Nevertheless, having said that, as we move forward to improved systems across the government, and invest to do that—and there is a great deal of modernization that is going forward right now that's very good. There is a problem, I would suggest to you, with the act as you look at all the reporting that takes place under FFMIA, FMFIA, the CFO Act and other areas. There is almost a competing hierarchy of reporting under these various acts. And we need to be, I think, taking a look at this.

I have talked to the Comptroller General about it, getting a better hierarchy of reporting. Because what happens quite frankly, sir, is that you end up opining as to compliance with FFMIA, and that gives you a series of issues to address, and then you've got material weaknesses and FMFIA problems, and I'm not sure the agencies know where to turn to—which problem to fix first. We need to get a rational system that says we have material weaknesses that the auditors have determined which would sweep in these FMFIA problems, and work on those, if you will. It is a little too complicated out there right now.

Mr. MILLER. One more question of Mr. Everson before you leave. It is related to H.R. 4685, the Accountability of Tax Dollars Act of 2002. What is OMB's views of H.R. 4685 and does it support the bill?

Mr. EVERSON. You will have to tell me a little bit more about it.

Mr. MILLER. It increases the number of agencies that are going to be required to have audits.

Mr. EVERSON. OK, great. Yes. Yes. We are for this because it brings down—this lowers the threshold and sweeps in some of the smaller agencies. We think that is a good idea. They end up with their financial statements.

The piece that I think we have some reservations about is really just what I talked about a minute. The FFMIA components of that; because it's not totally clear to me in a small agency that you should mandate that same adherence as to the technical requirements on systems, because those really have a benefit to us overall if you want to roll up the information into the governmentwide statements. It's not clear that you want—they've got a system that the auditors would say is adequate for their purposes. I'm not sure whether, in a \$30 million agency or program, you would want to mandate that they go through the investment cost of having a system that is actually totally in agreement with what we need to roll up the governmentwide statements.

That's the only reservation we have. But we are strongly in support of having you test functions attached to those agencies.

Mr. MILLER. What is OMB's views on the improper payment bill?

Mr. EVERSON. If you could tell me—there are a couple of different pieces that are moving on improper payments. This is the—you're talking about—the bill that's just moving forward now, which would really codify the reporting on programs by agencies to OMB? Yes, that would simply I think support what we are trying to do, and provide tighter deadlines, if you will, for us I think. So I think it would help us. Not any different to what Jack and his colleagues are trying to do for us. But having it in the law, sure.

Mr. MILLER. Mrs. Maloney.

Mrs. MALONEY. I have no further questions.

Mr. MILLER. Mr. Everson, I know you have an appointment. This is for Sally Thompson. Two questions: What needs to be done to ensure compliance with the Single Audit Act? And how effective are the provisions of the Single Audit Act? Is the act working?

Ms. THOMPSON. I think it's an excellent act. It provides the framework to be able to put the proper controls in place for the \$300-billion-plus expenditures. But there are gaps and holes, some of which we have recommended in the report that we are releasing today. Certainly adding more accountability in terms of, at the agency level, the rollup to the top management of the overall process and situations of a single audit finding; what kind of management decision memos have been issued; are they done on a timely basis; what are the conclusions on that? Have the recipients been notified and what is the timetable for followup on that? Not only that, it provides agencywide analysis to be able to understand what's going on out there in the area of grants and awards across the board.

We also feel, though, that there are a number of other areas at a governmentwide level that need to be addressed, many of which have been mentioned here today. We are concerned about the universe—that we don't know whether we are receiving all the required single audits. It's an honor system. We believe that's solvable. If you roll up that kind of information at the agency level, you ought to then be able to roll it up at the governmentwide level and be able to track it, accumulate it, look at it, understand this recipient that may be getting money from several different agencies that would fall under the requirement, even with the increased threshold of a single audit. It would provide you that kind of information.

Also in terms of what they call the cognizant agency, which are an agency that's responsible for following up on single audit findings that may involve money from other agencies. I think holding them accountable will increase the effectiveness of the act.

And then as we mentioned, we really believe there should be State reporting—that's not occurring right now—that goes up to the agencies, that identifies who those subrecipients are. Then you can go into the data base and see if those recipients are actually filing reports. Because right now, all the clearinghouse can do is to look at those that filed last year to see whether they filed this year. But if nobody's filed at all, they do not know that. So State reporting would provide a number of solutions to many of the problems that have been mentioned here today: who the subrecipients are, how much money they're spending. Also we don't know how much the corporations are getting of these awards as well, and that would identify that. And then we think the quality needs to be addressed to make the act more effective.

And there again, as we said, we really don't know the extent of those problems out there. And we think by partnerships with the IGs, and the State auditor being directed from OMB, would significantly give us the data that's needed to identify whether there is a problem with the quality of the audits out there.

I'm also a firm believer of performance accountability. We are holding the Federal agencies accountable for the programs and the performance and the results of those programs. I think that the

agencies should hold the recipients and the States should hold the subrecipients also accountable for the results of those programs.

Mr. MILLER. Thank you. Let me ask Mr. Knickerbocker a question. I think we met before on census issues. Mrs. Maloney and I chaired that committee for a few years. What type of user feedback information does the clearinghouse accumulate, and what could improve the quality of the clearinghouse?

Mr. KNICKERBOCKER. Well, Mr. Chairman, we do have the Single Audit Act user group. We interact with all the Federal grant-making agencies. The features of the clearinghouse, both the data dissemination system and the data collection system, have been crafted in part on the basis of the guidance from the user community. In other words, we are quite sensitive that the mechanics by which we receive the information, make it available to the agencies, respond to their needs.

So I think that we can say that we do have an active program of interaction with the Federal agencies. We have training programs for the Federal agencies to know how to access the clearinghouse. We are, as I indicated in my testimony, working with subsidiary groups of the CFO Council on issues of delinquent audits, how to increase responsiveness from delinquent audits. I did not mention it in my testimony, but in part of my written testimony, that we're also working with the CFO groups on checking the results in the clearinghouse against the three different Federal payment systems. I mean, the whole system is quite complex, and one of the issues is if you look at various ways that moneys move out to local entities, nonprofit entities, by comparing those money flows with the auditing flows, can you find discrepancies and therefore identify organizations that are not reporting and not fulfilling their auditing responsibilities?

So I suppose my general response is that we see ourselves as a service organization meeting the needs of the program agencies. I think the record will show that we've been responsive to their needs and I'm not aware that, any of the agencies feel that there are major shortcomings in what we are doing at this juncture.

Mr. MILLER. Thank you. Mr. Hinton, what are some of the key issues that need to be addressed to ensure quality and usefulness of audits? And in your testimony you mentioned that a few States are opposed to the single audit threshold. Can you elaborate further on their concerns?

Mr. HINTON. With regard to improvement in single audit quality at the local and the nonprofit level, our position would—would involve an increased accountability effort on the part of the IGs, on the part of State auditors, to review these reports for compliance with the significant sections of the act. We've been very successful in Georgia, on the local government side, recently in identifying deficiencies in the act and thereby being able to—to implement some methods for improving that.

One thing we also see at the local level is a lack of education or lack of awareness of the specific aspects of the Single Audit Act. And that's a twofold problem in that the entity which is obtaining the audit has a responsibility under Circular A-133 to engage a competent auditor. And what we see there is quite often there's a lot of shopping that goes on with regard to selection of the auditor,

and less of a concern about the quality of the audit that's going to be addressed there.

Mrs. MALONEY. Excuse me. May I ask a question? How are they able to shop who the auditor is?

Mr. HINTON. Well, I shouldn't say "shop." The attitude is to get—meet the minimal requirements of Federal regulation, Federal law, at the lowest cost. And the auditees need to pay more attention to the qualifications of that particular—

Mrs. MALONEY. In other words, the city or State can select the auditor? I thought the auditors came down from the Federal gentleman.

Mr. HINTON. No, ma'am.

Mrs. MALONEY. So they hire them from outside firms?

Mr. HINTON. Right. There are a variety of situations across the country. I know in our State—

Mrs. MALONEY. What's your State?

Mr. HINTON. Counties—Georgia—counties and municipalities are required by State statute, and obviously by the Single Audit Act, to obtain an audit that meets the requirement of the legislation and the implementing regulation. And it's the responsibility of who receives the Federal funds or expends those Federal funds to obtain that audit.

Mrs. MALONEY. Then they go to a private firm? I did not think that—I thought the auditors came down from the IG or from the government. I did not realize it was private auditors.

Mr. HINTON. No, ma'am.

Mrs. MALONEY. How do we know that the auditors are right? We had the same problem with Enron.

Mr. HINTON. It's not been a good year for auditors.

With regard to the change in the threshold, there are certain States which have linked the requirements for their State's monitoring efforts of State grants and such to the Single Audit Act. And under the Single Audit Act, a portion of that audit can be paid for with administrative dollars of the various Federal assistance programs.

By raising the threshold, certain States are concerned that participation in obtaining the audits might not be available, that it would drop off a number of their entities which are tied in their statutes to audit requirements.

However, those States which raised objections to that were limited, and surveys we conducted over the last 2 years have indicated favorable support for the \$500,000 level.

Mr. MILLER. Mr. Martin, how would the increase in the single audit threshold impact Education's oversight in monitoring school districts?

Mr. MARTIN. I don't think it would change the way we monitor school districts. I think the procedures we have in place right now, CAROI and the other ways we receive our audit reports, the fact that we're implementing a new data base, should help. But I don't think the implementation of the \$500,000 threshold will effect us at all. You know, the capabilities of our systems are not a function of what that threshold is.

Mr. MILLER. As an appropriator I find this whole question very interesting, since I'm on Labor-HHS in particular.

This is for Ms. Hanson. What impact will an increase in the audit threshold have on HUD's monitoring and oversight of housing authorities that receive Federal financial assistance? And HUD recently reported \$2 billion in net improper payments in housing subsidy programs. Has the Department used single audit results as a tool to determine the risk areas in the housing programs and, if so, how?

Ms. HANSON. Thank you. I will take the first one, and you will have to remind me of the second one. The impact on changing the threshold for the Public Housing Agency is not going to be significant. Currently 1,173 PHAs fall below the \$300,000 threshold, and they have total Federal revenues of approximately \$141 million. Those that are in the neighborhood of \$300,000 to \$500,000 it's another 304 PHAs with about \$118 million. That still leaves 1,627 PHAs with over \$500,000, for \$13.6 billion in Federal revenue.

You weren't here with the earlier question, but we will still receive the unaudited financial submissions from those housing authorities, so we will have the opportunity to be looking, and make an assessment of their financial condition based on those unaudited financial statements.

We don't believe by raising the threshold, it will impact our ability to continue our oversight of those housing authorities.

And the second one was—

Mr. MILLER. About the \$2 billion that's been reported in improper payments in the housing subsidy programs. Has the Department used single audit results as a tool to determine the risk areas in the housing programs and, if so, how?

Ms. HANSON. Not directly. How we analyze risk assessment in the Office of Public and Indian Housing is we look at a variety of features, including the amount of Federal resources going to that housing authority, performance under the PHAs system, and compliance issues such as audit findings to determine where we believe there is a high-risk housing authority that needs our attention either through additional technical assistance, greater monitoring of the documents that come in, or actual onsite attention.

I'm not really prepared to speak to what the Department is doing, but we do have a very aggressive program of trying to work up front with the housing authorities and other housing providers to assist them in validating the information that residents and potential residents provide.

Mr. MILLER. Thank you. Well, this will conclude the hearing. But let me for the record make some thank-yous to several people that made this hearing possible:

Russell George, the staff director and chief counsel; Bonnie Heald, the deputy staff director, Henry Wray, the senior counsel; Rosa Harris, the GAO detailee; Justin Paulhamus, the majority clerk; Michael Sazonov, the subcommittee intern; Sterling Bentley, the subcommittee intern; Joe DiSilvio, the subcommittee intern; and Yigal Kerszenbaum, subcommittee intern.

For the minority, David McMillen of the professional staff, and Ellen Rayner, the chief minority clerk. I thank the reporters, Michelle Bulkley and Joe Strickland.

With that, I thank you all very much for participating. I am sorry that Chairman Horn couldn't remain for the whole hearing, but I thank you very much.

[Whereupon, at 11:40 a.m., the subcommittee was adjourned.]

